HIGH SKILLS, LOW WAGES—PRODUCTIVITY AND THE FALSE PROMISE OF NAFTA

HEARING

BEFORE THE

EMPLOYMENT, HOUSING, AND AVIATION SUBCOMMITTEE

OF THE

COMMITTEE ON GOVERNMENT OPERATIONS HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

AUGUST 5, 1993

Printed for the use of the Committee on Government Operations

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HIGH SKILLS, LOW WAGES—PRODUCTIVITY AND THE FALSE PROMISE OF NAFTA

THURSDAY, AUGUST 5, 1993

HOUSE OF REPRESENTATIVES,
EMPLOYMENT, HOUSING, AND AVIATION SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2247, Rayburn House Office Building, Hon. Collin C. Peterson (chairman of the subcommittee) presiding.

Present: Representatives Collin C. Peterson, Floyd H. Flake, Karen L. Thurman, and John M. McHugh.

Also present: Edith Holleman, staff director; Andrea Nelson, counsel; Dave Rinebolt, professional staff member; June Saxton, clerk; and Michael D. Nannini, minority professional staff, Committee on Government Operations.

OPENING STATEMENT OF CHAIRMAN PETERSON

Mr. PETERSON. The subcommittee will come to order.

Today, we are going to look into the issue of productivity of the work force in America and Mexico, and the implications it might have on the NAFTA debate.

In the 1½ years since President Bush signed the North American Free Trade Agreement, supporters of the trade pact have vociferously denied that United States jobs would be siphoned off to Mexico because of the low wage structure there. U.S. Trade Representative Mickey Kantor has said repeatedly that Americans have nothing to fear because the average Mexican factory worker receives hourly wages and benefits worth $2.35 versus $16.17 for the U.S. worker. According to Ambassador Kantor, U.S. workers are "many times more productive" than Mexican workers.

These statements have been repeated by others. According to a recent column in the Washington Times, businesses stay in the United States because they can't find the kind of work force they need in Mexico. "Mexican workers produce only about 13 percent per hour as much as their American colleagues," this writer stated. When asked his source, he could only say he had "heard it somewhere in the White House" during the last administration.

Industry and business, however, tell a different story—a story that has been frequently ignored in the free trade debate. According to Business Week earlier this year, Mexico's emphasis is on both low wages and high productivity. In the new plants built by the United States and other multinational companies in Mexico, productivity ranges from 85 to over 100 percent of that of similar

United States plants, while total compensation remains at about one-seventh to one-tenth that of United States workers doing the same job. And these are not low-skilled jobs. These are jobs U.S. workers desperately want to keep, such as automotive and truck assembly jobs, and engine building, the cream of the automotive jobs in this country.

As a promoter of foreign investment based in Chihuahua City said in the Dallas Morning News, "we used to see ourselves as competitors with China for foreign companies that provided low-skill, low-wage jobs. Now we see ourselves as competitors with the United States for enterprises that provide high-skill jobs at lower wages."

A vice president of a U.S. electronics company put it very succinctly: "We run our Mexican factories with basically the same premise as in the U.S. They use state-of-the-art, expensive, very, very modern equipment. These are not high volume sweat shops."

They may not be sweat shops, but they don't pay a middle class wage. When we look at the actual wage paid to the worker after benefits are subtracted, it is about $1.50 per hour for a 48-hour week, or annual income of $3,744. Even if you agree with one of our witnesses—and I don't—that that amount in actual purchasing power translates into about $6,685 U.S. dollars—think about how little a family of four can purchase in the United States for $6,685; $6,685 is less than half of the $14,343 which defined poverty for a family of four in the United States in 1992. Even with two full-time manufacturing incomes, a Mexican family could not reach our poverty level. They cannot buy the cars, the refrigerators, or any of those U.S. consumer goods that the trade people say we are going to sell.

And that is what this debate is all about. It is about cheating productive Mexican workers out of their rightful pay and forcing United States workers making 7 times that to accept wage and benefit cuts to compete with these lower wages.

The question is, when will this change? The imposition of "el pacto," the government-union-industry agreement which continues to deliberately hold down wages to keep Mexico's low-cost competitive advantage over other countries. It makes a joke of the econo-pundits' statements that when productivity increases, wages will also increase. According to this week's Business Week, the pact has "postponed the income gains that should follow strong productivity growth."

Business Week goes on to describe Mexico's move as only one in a "new, brutally competitive world economic order that is emerging from the demise of the cold war. To stay competitive, companies are locating more facilities abroad, eliminating jobs, and investing in technologies to boost productivity. The peace dividend, at least in the short run for industrialized jobs, is unemployment."

According to Labor Secretary Reich, the high-wage manufacturing jobs in the United States are being replaced with low-wage service jobs, and there is no clear understanding of where new high-wage jobs are going to come from.

With these high levels of productivity and low wages in Mexico's export sector, it is not surprising that Zenith Television says that the primary reason it moved jobs to Reynosa, Mexico, was its wage

structure. The implications for U.S. workers are ominous. When Mexican workers can match, or even exceed, the productivity of workers in the United States but their wages are kept deliberately low, both the American and Mexican workers are going to end up on the short end of the stick.

Today's hearing will examine the wage and productivity levels of Mexican and United States workers in these new plants, particularly in the automotive industry. In their writings, our two U.S. witnesses have taken completely divergent views of this issue. Professor Harley Shaiken of the University of California is the author of "Myths About Mexican Workers," which compares the productivity of modern Mexican auto plants with those of the United States and Japanese automakers, and finds that Mexican plants are highly competitive.

Alan Reynolds is a senior fellow and director of economic research at the Hudson Institute. In a paper presented to a congressional seminar earlier this year, he wrote, "Mexican wages, like other low prices, have been low for a reason—Mexican productivity is low."

We also have a special witness this morning. We are honored to have with us Bertha Lujan of the national executive committee of the Authentic Labor Front, FAT, who arrived in the United States late yesterday. Señora Lujan, as a member of the independent labor movement, has personal experience in the linkage of Mexican productivity and wages, and we are pleased to hear from her this morning. She also heads the Mexican Action Network on Free Trade.

At this point I would be happy to recognize other members of the committee for opening statements. Mr. McHugh, do you have a statement?

[The opening statement of Mr. Peterson follows:]

STATEMENT OF COLLIN C. PETERSON, CHAIRMAN
EMPLOYMENT, HOUSING AND AVIATION SUBCOMMITTEE
August 5, 1993

In the year and a half since President Bush signed the North American Free Trade Agreement (NAFTA), supporters of the trade pact have vociferously denied that U.S. jobs would be siphoned off to Mexico because of the low wage structure there. U.S. Trade Representative Mickey Kantor has said repeatedly that Americans have nothing to fear because the average Mexican factory worker receives hourly wages and benefits worth $2.35 versus $16.17 for the U.S. worker. According to Ambassador Kantor, U.S. workers are "many times more productive" than Mexican workers.

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Industry and business, however, tell a different story -- a story that has been frequently ignored in the free trade debate. According to Business Week earlier this year, Mexico's emphasis is on both low wages and high productivity. In the new plants built by U.S. and other multinational companies in Mexico, productivity ranges from 85 to over 100 percent of that of similar U.S. plants, while total compensation remains at one-seventh to one-tenth that of U.S. workers doing the same job. And these are not low-skilled jobs; these are the jobs U.S. workers desperately want to keep -- automotive and truck assembly jobs -- and engine building, the cream of the automotive jobs.

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Today's hearing will examine the wage and productivity levels of Mexican and U.S. workers in these new plants, particularly in the automotive industry. In their writings, our two U.S. witnesses have taken completely divergent views. Professor Harley Shaiken of the University of California is the author of "Myths about Mexican Workers," which compares the productivity of modern Mexican auto plants with those of U.S. and Japanese automakers and finds the Mexican plants to be highly competitive. Alan Reynolds is a senior fellow and director of economic research at the Hudson Institute. In a paper presented to a Congressional seminar earlier

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Mexicans, Too, Are Wary of Trade Pact, Fearing Loss of Some Worker Protections

By DIANNA SOLIS A15
Staff Reporter of THE WALL STREET JOURNAL

MEXICO CITY – At the University of the Worker here, Manuel Fuentes gives his blue-collar audience a primer on U.S. and Mexican labor law.

"In the U.S., you have the right to strike, but the business owners have the right to replace the strikers," says the labor attorney to the amazed group of workers. "In our country, this is condemned."

U.S. union leaders looking to attack the North American Free Trade Agreement because of Mexico's allegedly weak labor laws might be equally amazed.

The issue of how workers are protected carries surprises for all sides and is prominently on the table today as U.S., Mexican and Canadian negotiators meet here to craft a side agreement to Nafta on labor. The labor pact and a similar understanding on the environment have been included in the bargaining as part of a Washington effort to win approval of Nafta from skeptics in Congress.

The Clinton administration has prepared a plan limiting the power of Nafta's labor and environmental commissions, allaying concerns here that they would intrude on Mexico's sovereignty.

The side agreements are designed to ensure that Mexico doesn't gain an advantage because of having lower standards.

But as Mr. Fuentes and other Mexican labor experts point out, while wages may be low in this nation of 85 million, job security and benefits are high, at least on paper.

Profit-sharing, paid maternity leave and government-run vacation getaways are all constitutionally mandated.

Christmas bonuses of 15 days' pay are mandatory. A dismissed worker must receive severance pay of three months, plus 20 days' pay for each year of service.

Enforcement of these worker-friendly provisions is another matter. Mexican experts say that compliance by large companies may be as high as 90%, but that almost all smaller companies violate the labor laws in one way or another.

Nafta makes unions on both sides of the border jittery. Victor Munoz, an AFL-CIO organizer in Los Angeles, says Mexicans worry that their labor laws will be degraded to equal those in the U.S. while his union worries that U.S. wages will be degraded to Mexican levels.

Consider the case of Conchita Abdala, whose Mexican benefits far surpass those of U.S. working women. When Mrs. Abdala, a legal secretary, became pregnant, she got 42 days of paid leave before and after the delivery. On the 43rd day after baby Roberto's birth, the government provided day care, and she returned to work. Even milk for Roberto was provided free. "It is fantastic," says Mrs. Abdala.

For these benefits and others, Mrs. Abdala contributes about 5% of her salary. Her employer pays about three times that amount. Mrs. Abdala's salary is about $1,000 a month.

Juan Saucedo, on the other hand, wasn't treated as well. The 31-year-old was fired a year ago from his $500-a-month job as a bank director's chauffeur. When he didn't get his legally mandated severance pay, Mr. Saucedo took his employment contract to the federal Conciliation and Arbitration board. "They told me I was going to lose because the employer had all the money," says Mr. Saucedo, speaking metaphorically of the advantage of big business over individual workers.

Mr. Saucedo's experience may not be so unusual. Laid off petroleum workers set up a shantytown for several weeks last fall in the capital's central square to demand their severance pay. After nearly a year, the oil monopoly agreed to pay millions of dollars to the protesters.

Mark Chassinat, who has operated a private mailing service for 17 years here, sees such events as part of a broader effort by Mexico's labor courts to move toward a middle ground. "Ten years ago, they were very much on the employee side," says Mr. Chassinat. "Now they are becoming more employer-oriented."

Mr. Chassinat adds, "No one is given three months' severance pay automatically anymore. That law is no way to attract foreign capital."

Observers say the change to a more employer-friendly interpretation of labor laws is largely a result of the new climate created by the Salinas administration.

While Mexican workers have a constitutional right to strike, potential strikers must leap several legal hurdles before the strike is considered legitimate. In 1992, unions announced plans to exercise that right some 7,000 times, according to the Conciliation and Arbitration Board. However, only 2% of the planned strikes resulted in plant shutdowns.

Mr. Fuentes, the labor attorney, refers to the labor courts as a "freezer for labor rights."

Jaime Vega, a 31-year-old graphic designer, thought his union had cleared the hurdles when he and his fellow workers called a strike against El Heraldo de Irapuato, a newspaper in a central Mexico farming town. The workers' union was officially recognized and the strike was declared legal. But last month, a labor court overturned a lower-court ruling and declared the strike illegitimate.

HEADING SOUTH

U.S. companies plan major moves into Mexico

BY GEORGE ANDERS

MOST U.S. COMPANIES see themselves as winners in a North American Free Trade Agreement—and 40% are inclined to move some manufacturing to Mexico in the next few years.

At the same time, more than one-third of U.S. companies think that a regional trade accord will be at least somewhat unfavorable for American workers. And the origins of any new jobs created in Mexico are likely to be contentious. Some jobs are likely to be ones that otherwise might have gone to Southeast Asia or other low-wage areas; others may represent a transfer of work from the U.S.

Those are some of the findings that emerge from a poll of 455 top U.S. executives, who were asked their opinions about steps being taken to cut tariffs and open up trading between the U.S., Mexico and Canada. The survey was conducted by Roper Organization for The Wall Street Journal. It encompasses companies in more than 20 industries, from electronics to tobacco.

Among the poll's conclusions:

• Support for the North American trade pact is strongest among large companies. Apprehensions are higher for executives at small companies, particularly those who say they don't know much about the accord.

• Telecommunications, banking and high technology are the U.S. industries that are expected to benefit the most from the trade accord. No industry is rated as a victim by a majority of respondents, but more than a third of respondents think U.S. textile companies could suffer.

• About one-quarter of U.S. executives say they are likely to make a capital investment in Canada in the next few years—significantly fewer than the percentage targeting Mexico.

• The development of regional trading blocs is endorsed by a 2-to-1 margin, with executives saying they want a North American alliance that competes with similar groupings in Europe and Asia.

• [illegible]lly a 3-to-2 margin, executives say they would support an even wider regional trade agreement that would cover all of Latin America.

In general, some 81% of executives say they are strongly or mostly in favor of the North American trade accord. Just 12% oppose the pact. The approval rating reaches 86% from executives who say they knew at least a fair amount about the pact; some 64% of executives who say they knew little or nothing about the agreement are willing to endorse it.

Typical among the optimists is James P. McCann, president of Bridgestone/Firestone Inc. "As we move more and more toward a common market for North America, that will generate more opportunities for business," Mr. McCann says. He's particularly bullish on Mexico, where his company already makes 1.5 million tires a year and might expand.

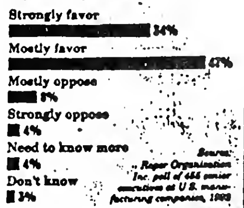
At Caterpillar Tractor Co., executives are similarly upbeat about Mexico. Last year, Caterpillar exported 1,200 units of earth-moving equipment to Mexico, for a total of more than $150 million in sales. That figure could rise further in the next few years, says Caterpillar trade specialist William Lane, once Mexico slashes or eliminates duties of 15% to 20% on imports from the U.S., thereby making U.S. goods even more competitive against Japanese imports.

Less sanguine, though, is Frederick

Continued on Page R7

Free-Trade Fans

WHEN U.S. corporate executives were asked whether they are strongly in favor of a North American Free Trade Agreement involving the U.S., Canada and Mexico, mostly in favor, mostly opposed or strongly opposed, they said:



Source: Roper Organization Inc. poll of 455 senior executives at U.S. manufacturing companies, [illegible]

ALSO IN THIS REPORT

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THURSDAY, SEPTEMBER 24, 1992

WORLD BUSINESS

One America

HEADING SOUTH

Continued from Page R1

Dint, chairman of Mayfair Mills Inc., in Arcadia, S.C. While Mr. Dint says he admires the principle of free trade, he adds that any agreement "has to be executed properly" before he can support it. And Mr. Dint observes that the U.S. textile industry already has been hard-hit by competition from a wide range of low-wage countries, including Mexico.

Overall, Roper found, 71% of respondents feel the trade pact will be benefi-

> Among the companies with $1 billion or more in sales, some 95% endorse the trade pact. But at companies with fewer than 500 employees, only 70% of executives aprove.

[illegible] for their company. An additional [illegible] say they aren't sure what the impact would be, and just 14% say it could hurt their business.

Among companies with $1 billion or more in sales, some 95% endorse the trade pact. But at companies with fewer than 500 employees, only 70% of executives approve. And among companies in states that bordered on Mexico, one in five executives opposes the pact—one of the highest negative ratings.

In a sign of American eagerness to expand in Mexico, 40% of respondents say it's very likely or somewhat likely that they will shift some production to Mexico in the next few years. That share is even higher—55%—for executives at companies with $1 billion a year in sales.

Hoover Co., for example, plans to start making hand-held vacuum cleaners at a factory it operates in Ciudad Juarez, just across the border from El Paso, Texas. Hoover currently makes such products in Asia. But a recently completed internal analysis shows that it would be cheaper to switch production to Mexico, says Hoover President Brian Girdlestone.

Mr. Girdlestone acknowledges public concern about the loss of U.S. jobs, but he says that issue doesn't apply to Hoover's decision. "We're adding jobs in North America," he says. "We're bringing them back from Southeast Asia."

Firestone's Mr. McCann adds that it would be "shortsighted" to switch production to Mexico in an effort to capitalize on lower wage costs. Pay scales for skilled workers in the U.S. and Mexico already are closer than many people realize, he says. "And as Mexico gets more prosperous, wages are likely to rise," he says.

Still, some 39% of respondents say they think the trade pact would have a mostly unfavorable or very unfavorable impact on American workers.

About one-quarter of executives surveyed say they are very likely or somewhat likely to use the trade accord as a "bargaining chip" to try to hold down wages in the U.S. Another quarter say that such a tactic isn't too likely, and nearly half say it isn't likely at all.

While Mexico is the main area of focus, some executives signal increased interest in Canada as well. The U.S. and Canada significantly reduced trade barriers in 1988. The new North American trade pact aims to extend the terms of the 1988 accord and apply them throughout the continent.

Overall, 23% of executives say the 1988 agreement led them to increase exports to Canada. Some 9% say they invested more in Canada, and 7% say they faced increased competition from Canadian companies. But nearly two-thirds of the respondents say that the 1988 U.S.-Canada agreement hasn't affected their business.

Looking ahead, 27% of respondents say that they are very likely or somewhat likely to make a capital investment in Canada in the next few years. Several executives say the current recession in Canada has muted their interest in expanding there. Once Canada's economy picks up, they say, they are more likely to take advantage of any opportunities presented by liberalized trade.

Some critics of the North American trade accord have complained that it will encourage the development of regional trading blocs in Europe, North America and Asia, each pitted against the other. But some 56% of executives surveyed say that forming a North American regional bloc would be a good idea.

"The real, special value of [the trade pact] is that it makes the region more competitive vis-a-vis the rest of the world," says Nancie Johnson, head of trade policy for Du Pont Co. That might lead Du Pont to base a textile-fibers plant in Mexico, for example, she says, even though local Mexican demand alone couldn't support the facility. But if the plant could easily sell its output throughout North America, then it would be an attractive proposition.

Many companies, in fact, see the North American Free Trade Agreement as a first step toward a tariff-free common market that could cover all of the Western Hemisphere. Some 56% of all executives—and 70% of large-company executives—say they favor a trade accord that would include all of Latin America.

"If this is successful," says Sandra Masur, the chief Washington-based trade negotiator for Eastman Kodak Co., "what it accomplishes could potentially be applied to other markets like Brazil, which are chaotic now." ■

MR. ANDERS IS A STAFF REPORTER IN THE WALL STREET JOURNAL'S NEW YORK BUREAU.

HOW THE SURVEY WAS CONDUCTED

Two months ago, the Roper Organization conducted phone interviews with 455 senior executives of manufacturing companies ~~through-out~~ the continental U.S. In a separate sample, 50 senior executives of the largest manufacturing companies in the country were interviewed.

The sample was randomly chosen from a list of private and public companies with 100 or more employees. Within each company, one senior executive was interviewed. The completed sample included: 150 companies with 100-499 employees; 150 companies with 500-999 employees; and 150 companies with 1,000 or more employees. The completed sample was weighted by employee size to reflect the actual distribution of all listed manufacturing companies in the country.

The sample of the largest companies was drawn randomly from a listing of the top 500 manufacturing concerns based on sales revenue.

According to Roper, the odds are 19 out of 20 that if the survey of 455 executives had included every senior executive at all listed manufacturing companies in the country with 100 or more employees, the findings would differ from the survey results by no more than five percentage points in either direction. The sampling error for smaller subgroups is larger. ■

A Polling Sampler

The Roper Organization asked top executives of U.S. manufacturing companies a variety of questions about the proposed North American Free Trade Agreement. Here are some of their answers.

DO YOU THINK that the proposed free-trade agreement will be very favorable, mostly favorable, mostly unfavorable or very unfavorable as far as the following are concerned?

	VERY FAVORABLE	MOSTLY FAVOR-ABLE	MOSTLY UNFA-VORABLE	VERY UNFA-VORABLE	DON'T KNOW
Large U.S. businesses	22%	59%	6%	3%	10%
Small U.S. businesses	13	48	21	8	10
U.S. consumers	25	54	7	2	9
U.S. workers	13	38	30	9	10
Your business	25	46	10	4	16

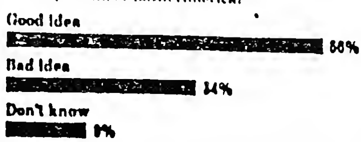
FOR EACH of the following industries, do you think the trade pact will generally be beneficial or detrimental to that industry, or will it have very little effect?

	BENEFICIAL	DETRI-MENTAL	LITTLE EFFECT	DON'T KNOW
Agriculture	50%	12%	26%	12%
Automotive	68	17	12	3
Banking	57	6	23	18
Building materials	57	16	17	10
High technology	66	8	22	8
Energy	59	9	22	9
Pharmaceuticals	52	9	21	18
Metals and mining	52	17	17	14
Telecommunications	78	6	13	7
Textiles	45	31	11	13

IF NAFTA is ratified, which of the following are very likely to happen at your business within a few years, somewhat likely to happen, not too likely to happen, or not at all likely to happen?

	VERY LIKELY	SOME-WHAT LIKELY	NOT TOO LIKELY	NOT AT ALL LIKELY	DON'T KNOW
Nafta will be used by your company as a bargaining chip to keep down wages in the U.S.	10%	14%	26%	48%	2%
Your company will make a capital investment in Mexico	14	24	22	38	3
Your company will make a capital investment in Canada	9	16	23	47	2
Your company will face increased competition from Asian companies selling from Mexico	17	23	23	32	6
Your company will lose sales to less-expensive Mexican-made products	12	26	26	34	2
Your company will shift some production to Mexico	13	27	20	37	3

DO YOU THINK it would be a good idea or bad idea to have a free-trade agreement that essentially includes not just Canada and Mexico, but all of Latin America?



Note: Totals may not add up to 100% due to rounding

Source: Roper Organization for poll of [illegible] executives at U.S. manufacturing companies, [illegible]

Mr. McHugh. Thank you, Mr. Chairman.

Very briefly, let me again express my appreciation to you and to the full committee for this ongoing series of hearings, this third in an effort to examine the impact and the importance of the North American Free Trade Agreement proposal.

Certainly, as you noted, Mr. Chairman, the discussion of productivity is one that continues the controversy, one that highlights the differences of opinion that seem to abound on this particular subject, productivity versus cost per unit worker, et cetera. I commend you for having here today proponents of both sides of the issue.

As I have tried to do during these hearings, I will today try to keep an open mind and I am very interested in learning what our witness have to say. So with that I will turn it back to you, and again, thank you.

Mr. Peterson. Thank you very much, Mr. McHugh. We appreciate your being with us.

I will recognize our Democratic friends in the order they appeared in the subcommittee, first Congresswoman Thurman from Florida.

Mrs. Thurman. Thank you, Mr. Chairman. Actually, in the interest of time, what I would like to do is submit my opening statement for the record so we can get on with the business.

Mr. Peterson. So ordered.

[The prepared statement of Mrs. Thurman follows:]

OPENING STATEMENT

Thank you Mr. Chairman. I have a few brief remarks. First, let me take this opportunity to thank you for holding another hearing on the effects of NAFTA on employment in the United States and Mexico. As you mentioned Mr. Chairman, today's hearing deals with the question of productivity, specifically the question of whether or not Mexico's productivity level is on par with that of the United States.

I am opposed to NAFTA for numerous reasons. I too have heard the NAFTA and free trade proponents claim that this agreement will benefit workers on both sides of the border. We are told that the Mexican worker will be able to purchase American goods. On that point, I have just one simple question, how? Since the wage scale in Mexico is substantially below the poverty level in the United States, how is the Mexican laborer going to be able to purchase our goods and services? I just cannot buy various economists' arguments that when productivity increases, wages will increase. Mexico is a clear example to the

contrary and I certainly do not believe that NAFTA will change the situation.

Mr. Chairman, over the past few weeks, I have been fortunate enough to participate in a series of Special Orders on the Floor dealing with NAFTA. During a recent one, Majority Whip Bonior made a point that I think bears repeating. He was reviewing the effects of the free trade agreement between the nations of the European Community. Mr. Bonior stated that between 1989 and 1993, the nations of the EC will spend almost $100 billion on worker retraining and economic development programs for the power areas of Europe. After spending that amount of money, the difference in wages between the rich and poor nations of Europe, Germany and Portugal, is still less than half as big as the difference between the U.S. and Mexico.

If NAFTA is approved, how much will we have to spend to retrain our workers and find jobs for dislocated workers? $150 billion; $200 billion; more? The costs are too high! If NAFTA wins, both the

United States and Mexico lose, regardless of the equality in productivity levels.

Finally Mr. Chairman, let me say that I am also looking forward to hearing from today's witnesses, and I thank them for being here.

Mr. PETERSON. Congressman Flake.

Mr. FLAKE. Thank you, Mr. Chairman.

Let me commend you again for being vigilant as it relates to bringing attention to the issues related to a NAFTA agreement, and to deal with, I think, what I consider to be very poignant and realistic questions as it relates to what ultimately happens, not only for American workers, but also workers in Mexico.

Even as our corporate leaders salivate at the possibility of being able to move into Mexico and be able to participate in what they consider to be new markets that they believe will be very valuable and be very profitable for them, there is a reality that we must raise, not only the economic questions, but also serious moral questions, which I think you are doing today in this hearing in regard to productivity, and in regard to impact of this agreement as it relates to all workers.

And so not only do I commend you but I encourage you to continue to do so, because I think it is important and imperative that we do not give up any high moral ground in order to accommodate those interests who desire that we move in a very expeditious fashion. I think it is better that we take the appropriate time, do it properly, if it is to be done at all, and in reality ultimately be able to hold our heads high because we have done the right thing for workers both on the Mexican side of the border and on the Mexican side. Thank you. I yield back.

Mr. PETERSON. Thank you. We appreciate your being with us this morning.

Mr. MCHUGH. Mr. Chairman, forgive me for interrupting, but I would ask that the hearing record will be held open so that all Members may submit statements.

Mr. PETERSON. Without objection.

We will ask Señora Lujan to testify first. She has a number of meetings that she is taking part in on the Hill, so to accommodate her schedule we are going to put her on. I also would like to announce that she is going to be available to meet with Members from 3 to 4 this afternoon in the Rayburn room for anyone who would like to visit one-on-one with her; she will be available for 1 hour to meet with Members this afternoon.

So with that we would like to ask Señora Lujan to join us at the witness table. As I said, she is a member of the national executive committee of the independent Mexican labor union known as the Authentic Workers Front or FAT, and we welcome her to the committee. This is her interpreter, evidently. We welcome you as well.

It is a custom of the Government Operations Committee, which holds investigative hearings, to swear in all witnesses so that we do not discriminate against any of them. So, Mrs. Lujan, do you have any objection to being sworn in?

Mrs. LUJAN. No.

[Witness sworn.]

Mr. PETERSON. Welcome to the subcommittee.

STATEMENT OF BERTHA LUJAN, MEMBER, NATIONAL EXECUTIVE COMMITTEE, AUTHENTIC WORKERS FRONT [FAT], MEXICO

Mrs. LUJAN. Thank you. Good morning. I am sorry, my English is so bad, so I need a translation. Thank you very much for this.

I think that this is a very opportune hearing, principally because right now the discussions in terms of the environment and labor are still being discussed, and we can still have input. And I think that the discussion of productivity and wage levels has a direct bearing on the parallel agreements which are being discussed.

There is a permanent demand out there, both in the United States and Mexico, and in Canada, that the labor accord must include a chapter on wages or salaries, an accord which must come up with some kind of an agreement on wage parity for North America, which would allow us to move toward the highest wage levels in the region.

This is very important and has to do not only with the low wage levels in Mexico, but also with the process of recent years in the United States and Canada of falling wage levels. And the free trade agreement could bring all of the wage levels down so that we could be all falling toward the lowest levels in the United States and Canada, too. And in Mexico, indeed, we do have very low wage levels.

But this possibility of falling wage levels also affects the workers here in the United States. And the only way to face or deal with this process is to establish in these parallel accords on the labor factor, since the free trade agreement, as we know, has not done this, assure that this process of wage parity be moving upwards.

And we do know that the possibility of rising wages is directly linked with productivity. But productivity also has to do with the possibility of training the labor force, as well as possibilities of technological advance; and thus, the possibility of Mexico to move forward in productivity, go through the possibility of increasing wages, but also the possibility of having increased labor training programs, and access to new technologies, is another thing that is not included in the free trade agreement.

So that these, too, are demands which have been presented to be included in that agreement. If that parallel labor accord which is being considered does not include any of this, we will have ratified what is already presented in the agreement. And that means leaving the whole wage question aside, leaving the whole training question aside, and also the whole technological factor.

In May 1992, there was signed in Mexico the accord on raising productivity and improving quality of products. That was a political accord between the three sectors; government, private enterprise, and official trade unions. And this accord had been promoted mainly by the executive branch, obviously with a view to achieving a ratification of the free trade agreement. And that is an accord which does not have juridical value. And it reflects some particular needs for raising productivity in Mexico.

But it is an accord like so many others that we have in Mexico, which has been developed as a top-down matter, without a social consensus, not even from the sectors which signed it. And so it

could remain simply an accord in black and white, but it has no efficacy in practice.

But nevertheless, I would like to highlight four characteristics in terms of the content of this accord, because in terms of content it is rather an ideal accord which does reflect some real issues to be dealt with. For example, the accord reflects a very high level of understanding of the productivity factor.

It says that to be productive is to do things better and more—using your resources more rationally, participating more actively in technological creativity, but especially opening it up to a greater participation of the workers in the question of productivity.

And within the accord, of fundamental importance to the human factors included, it says that the work force is a valuable resource which must be cultivated and not merely something to be bought and sold at the cheapest cost.

The accord also speaks of the necessary participation of the trade unions in the productivity question, and that both the workers and society must be coparticipants in the benefits which come from productivity.

And we do agree with all of these concepts, that is, a good accord on productivity, just as the Federal law on labor in Mexico is a good one generally, or some of the norms on social security. The main problem is that the social and political structure in Mexico, concretely, the political economy implemented—or the economic policy implemented by the recent regimes in Mexico, makes an accord totally ineffective, inoperative. And why do we say this?

The accord says that we must connect productivity with wages. Over the recent years in Mexico, we have lived a heterogeneous process in which different branches of the manufacturing industry have passed through strong crises. But there are other industries which have grown. And within that growth there has also been an increase in productivity.

Nevertheless, on the wage question the norms remain the same. There has been no relationship between the increase in productivity and possibilities for a rise in wages.

Why? Because over and against the productivity accord, there is a pact of economic stability signed by the very same sectors that signed the productivity accord, and perhaps the very same individuals who have been developing over several stages top wage ceilings in terms of salary.

That means there is a uniform policy in terms of rise in wages, which has to do with a policy in search of bringing in foreign investment, offering cheap labor force, and, it is said, in order to control inflation. So this keeps the wages low for reasons that have nothing to do with productivity.

So that if we would have the same salary or wage possibilities in every industry, at the service industry, that would mean that there is no possibility of connecting productivity with wages. And as long as these policies remain in place of wage control, as long as the cheap labor force in Mexico continues to be the principal comparative enticement in order to bring in foreign investment there, the working people in Mexico, we remain condemned to receiving low wages for a long time now, with or without the free trade agreement. And that is why we say that the free trade agree-

ment will not necessarily bring higher productivity nor better wages for the Mexican working people.

In the document which we have brought here for all of you, there are a series of suggestions and proposals which we have offered you from the independent trade union movement in Mexico. These are proposals in the face of the problem of productivity and wage levels. And I am not going to present them for you aloud because we have run out of time.

Thanks a lot for the opportunity to come.

Mr. PETERSON. Thank you very much, Señora. We appreciate your testimony.

[The prepared statement of Mrs. Lujan follows:]

PRODUCTIVITY AND WAGES IN MEXICO

PREPARED STATEMENT BY

BERTHA E. LUJAN,

NATIONAL EXECUTIVE COMMITTEE,

AUTHENTIC LABOR FRONT (FAT),
MEXICO CITY

BEFORE THE EMPLOYMENT, HOUSING & AVIATION SUBCOMMITTEE

OF THE COMMITTEE ON GOVERNMENT OPERATIONS

U.S. HOUSE OF REPRESENTATIVES

WASHINGTON, D.C., 6 AUGUST 1993.

I. The National Accord for the Enhancement of Productivity and of Quality

On May 25, 1992, the "Accord for the Enhancement of Productivity and of Quality" was signed in Mexico City by representatives of the federal government, business and official unions, after a two-year negotiating period.

This is a top-down accord, imposed upon the workers by the President through the Department of Labor of the Government of Mexico. It was signed to pave the way for the proposed North American Free Trade Agreement (NAFTA).

The main characteristic of this Accord was that the vast majority of workers, and even business, only learned of it the very moment it was signed, as a *fait accompli*. As it is often the case in Mexico, only a very limited number of people participated in the process and in the signing of this Accord.

We present below our point of view on this Accord, analylzing both its content and its feasibility.

In relation to its content, it must be said that it incorporates very advanced concepts in its general framework. Taking certain basic points and general guidelines as a point of departure, it boils down to the commitment by each corporation or employer to implement and enforce the specific programs agreed upon by labor, business and government.

From our point of view, there are four salient features of this Accord:

a) The concept of productivity, defined as "doing more and doing it better"; a more rational use of available resources, actively participating in innovations and technological change. It also emphasizes the need to open up avenues for "a more active and creative participation of the workers in economic activity and in the benefits generated by this activity".

b) The emphasis on human resources, which demands "a replacement of the narrow notion that manpower is a cost in production that must be minimized, for a new approach that considers human resources as a precious element that must be duly valued".

c) The participation of workers and of their organizations. An approach is proposed that "would look at labor unions as valid interlocutors in the development of an organization". The will is expressed to "favor a constant flow of information from the top management levels to the employees at the bottom... as well as stimulating feedback from the rank and file to management".

d) The explicit commitment to properly compensate the workers and society for increases in productivity.

The spirit and text of this accord are, no doubt, positive. However, if we look at reality as it is lived by the Mexican workers, we would be very wrong to be pleased only with these general principles. The accord served the government's purpose to look good outside the country, but given the prevailing political and social conditions in Mexico, there is only a scant possibility that the spirit of this accord could go into effect.

II. <u>The Accord for Productivity VS. Reality in Mexico</u>

1. In the first place, the fact that this is an elite Accord severly hinders the likelihood of its implementation. The Pact for Stability and Economic Growth (El "Pacto") is also an elite accord, but it has been enforced by the government through many ways. The situation is quite different when it comes to implementation of the Accord for Productivity. In this case, it is essential that the different sectors be convinced of its relevance and that they be willing to implement it.

2. Secondly, the Accord in and by itself has no legal value. It is a document signed in good faith that calls for the goodwill of all the parties involved.

3. The Accord is in sharp contrast with the reality it is supposed to address. The everyday climate for labor in Mexico is characterized by a tight economic and political control, rather than one of productive collaboration.

The absence of freedom to organize for trade unions, and the everyday obstacles for workers to elect their leadership according to their interests simply impede the existence of channels for expression and participation.

Workers' participation is usually not a characteristic of a given workplace in Mexico. In general terms, business promotes the subordination of unions. Corporations like to deal with docile unions from the outset of the bargaining process leading to a collective convention. Some time down the road, they will say that unions in Mexico have a very backward labor culture, but here the corporations are only pointing out at a problem they have fostered themselves for years.

In recent years, a traditional concept of productivity has been put into practice in Mexico. Businessmen, in general, have understood productivity as "doing more with less"; i.e., reducing the cost of manpower through such means as the increase of the workload, layoffs, a reorganization of the working process, the increased use of technology, etc.

The workers still do not have a say when it comes to restructuring production, since these decisions are singlehandedly taken by management. Moreover, further flexibility of the labor market is achieved through the elimination of certain clauses in the

collective convention which protect the rights of workers.

III. Productivity and wages

Using all the abovementioned methods, productivity in Mexico has increased especially in those sectors of economic activity that have managed to grow despite the crisis; namely, food, beverages and tobacco; chemicals; oil derivates; rubber and plastics; basic metal industries; metallic products; machinery and equipment, etc.

However, this increase in productivity has not been accompanied by an increase in real wage levels. The government continues to advocate wage suppression as a deliberate policy that is enforced regardless of the level of inflation.

The official discourse is intended to create expectations that real wages will rise pari passu with an increase in economic growth and of productivity. In Mexico, in recent years, there has been economic growth and a significant increase in productivity, but wages continue to fall. This is illustrated by Graph 1 at the end of this text.

Economic growth in the different sectors of the economy has been quite uneven. As it stems from Chart 1, productivity in the manufacturing industry is increasing, but wages are lagging behind and they continue to fall.

There is a simple explanation for this: wages in Mexico are a dependent variable, subordinated to the aims of boosting exports, attracting foreign investment, and holding down inflation. That is why we believe NAFTA will only compound this trend. However, the decline in wages must be halted if the middle class in Mexico is to afford imports from the U.S.

It is not true that NAFTA will bring, by definition, an increase in the income level of the majority of Mexicans. This thesis only serves the interest of the propaganda of the Mexican government and does not resist a comparison to reality.

IV. Productivity and wages under NAFTA

Independent trade unions in Mexico have put forward the following demands to be included in the supplemental agreement on labor, currently being negotiated by the governments of Mexico, Canada and the U.S.:

1. Participation of workers in the restructuring of the production process;

2. Increases in productivity must not give way to an overexploitation of the workforce; instead, they should be an essential ingredient in an overall process of improvement of working conditions;

3. Benefits from increased productivity should also accrue to the workers, not only to management;

4. Workers' training programmes should be included in all programs to increase productivity;

5. The new performance schemes should not harm the workers' physical and mental integrity;

6. Social and structural conditions should be generated so that increases in productivity allow for a more rational development of society as a whole. This kind of development should have as its main characteristics freedom of organization, democracy and the advancement of the communities.

Meager salaries as those paid to Mexican workers are hardly an stimulus to increase productivity. The daily agony to survive forces the workers to have several jobs simultaneously, to work overtime on a permanent basis, or to put aside training forever.

Low salaries and organizational subordination are structural impediments for further increases in productivity. The Mexican workers are committed to increase productivity, but it is essential that the minimal conditions for this increase be met.

Mexico City, D.F., August 1993.

GRAPH 1: PRODUCTIVITY AND REAL WAGES

Source: "La politica salarial en el modelo neoliberal 1976-1992", Alberto Arroyo, Universidad Autonoma Metropolitana, Mexico City. The author uses official figures by Banco de Mexico and Instituto Nacional de Estadistica, Geografia e Informatica (INEGI).

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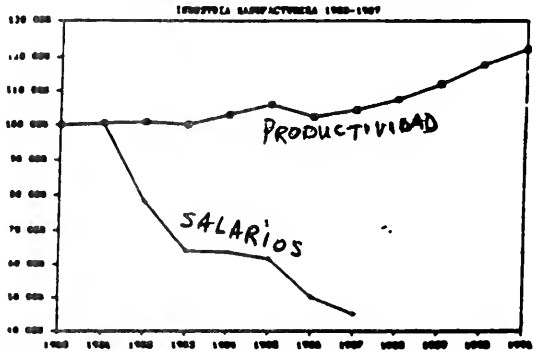
Alberto Arroyo
economista UAM.

PRODUCTIVIDAD/SALARIOS REALES



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...5/93
to accompany testimony of
Bertha Luján

F A T

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PRODUCTIVIDAD Y SALARIOS EN MEXICO

Bertha E. Luján
FRENTE AUTENTICO DEL TRABAJO,
MEXICO.

EL ACUERDO PARA LA ELEVACION DE LA PRODUCTIVIDAD Y LA CALIDAD.

El 25 de mayo de 1992 se suscribió en México el denominado "Acuerdo para la Elevación de la Productividad y la Calidad", por parte de los representantes del gobierno, empresarios y sindicalismo oficial, culminando así un largo proceso iniciado desde 1990.

En realidad, se trata de un acuerdo cupular, impuesto por el Ejecutivo a través de la Secretaría de Trabajo y Previsión Social, erigido con vistas a la firma del Tratado de Libre Comercio de América del Norte.

La característica escencial que prevaleció en la discusión del mencionado Acuerdo, fue la negociación de cúpula, en la que la inmensa mayoría del sector obrero e incluso, empresarial, sólo se enteró a partir de hechos consumados. Como es frecuente en el país, sólo reducidos grupos fueron llamados a participar en el proceso, o incluso en la firma del Acuerdo.

La suscripción del Acuerdo sin embargo, haya como haya sido, enfrentó a los mexicanos a dos reflexiones obligadas: una en relación a su contenido y otra sobre las posibilidades de convertir sus términos en una realidad.

En relación al contenido del Acuerdo, hay que decir que se integran conceptos muy avanzados en su estructura general. Partiendo de ciertas premisas, puntos básicos, líneas de acción y consideraciones, se llega a plantear compromisos finales en los que resalta el Acuerdo de suscribir dentro de cada empresa o centro de trabajo los programas específicos que concierten los sectores.

A nuestro juicio, hay cuatro elementos que se distinguen en el Acuerdo, cuyo contenido compartimos:

a) El concepto de productividad que se refiere a "hacer más y mejor las cosas", utilizar más racionalmente los recursos disponibles, participar más activamente en la innovación y avances tecnológicos, y "abrir cauces a toda la población trabajadora para su más activa y creativa participación en la actividad económica y en los frutos generados por ella".-

b) La preeminencia que otorga a los recursos humanos, que exige "reemplazar la visión estrecha que tiende a considerar a la mano de obra como un factor de costo a minimizar, por un nuevo enfoque que considere a los recursos humanos como un elemento valioso que requiere ser cultivado y debidamente valorado".

c) La participación de los trabajadores y sus organizaciones. Se compromete un enfoque que "contemple a las organizaciones laborales como interlocutoras válidas en el desarrollo de la organización". Hay voluntad de "favorecer el flujo constante de información desde los más altos rangos directivos hasta los empleados de menor nivel... y a estimular la retroalimentación desde la base hasta los puestos directivos..."

d) El compromiso de compartir con el trabajador y con la Sociedad los beneficios de la productividad.

Así, el acuerdo suscrito indudablemente es bueno. Sin embargo, a partir de la realidad que vivimos los trabajadores en México, mal haríamos con regodearnos en su contenido. El acuerdo satisfizo la urgente necesidad del gobierno de dar la mejor cara al exterior, y dadas las condiciones políticas y sociales que prevalecen en el país, hay pocas posibilidades reales de que éste se instrumente en la realidad cotidiana.

ACUERDO DE PRODUCTIVIDAD VS. REALIDAD POLITICO-SOCIAL

1. En primer lugar, el carácter cupular del Acuerdo limita evidentemente sus posibilidades de cumplimiento. El Pacto para la Estabilidad y el Crecimiento Económico (que fija los topes a los aumentos salariales año con año) es también un Acuerdo cúpula, sin embargo, éste se ha hecho cumplir por el Estado de distintas maneras. En materia de productividad, no es lo mismo, por lo que realmente los sectores deben estar convencidos y dispuestos a hacer factible éste Acuerdo.

2. En segundo lugar, el Acuerdo en sí mismo no tiene validez jurídica. Se trata de un documento de buena fe que convoca a la voluntad de los sectores.

3. El Acuerdo contrasta con una realidad muy lejana a sus pretensiones. Las prácticas sindicales en México están cifradas en un esquema de control social y político, más que en un esquema de colaboración productiva.

La ausencia de libertad sindical, los cotidianos impedimentos para que los trabajadores se representen y organicen de acuerdo a sus intereses impiden la existencia de canales de expresión y participación.

La promoción de la participación obrera no suele estar presente en nuestros centros productivos. En general, el empresariado promueve un sindicalismo sumiso [illegible] a [illegible] de la firma inicial del Contrato Colectivo antes de contratar trabajadores, y se queja a la vez del atraso en la cultura laboral que él mismo ha promovido durante años.

En los últimos años, se practica en México precisamente un concepto tradicional de productividad. El empresario en lo general, ha entendido la productividad como "el hacer más con menos", esto es, reducir el costo de la mano de obra a través de la intensificación del trabajo vía reajustes de personal, reorganización de los procesos de trabajo, introducción de nuevas tecnologías, etc. Se mantiene también la unilateralidad empresarial en los procesos de reestructuración productiva; se imponen sistemas flexibles a partir de la reducción de cláusulas contractuales que protegen derechos de los trabajadores.

LA PRODUCTIVIDAD Y LOS SALARIOS.

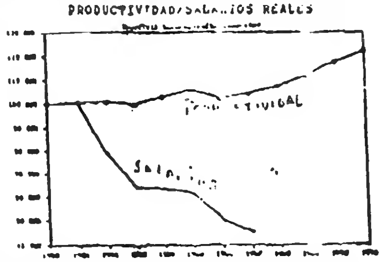
A través de éstos métodos, se ha conseguido en México elevar los niveles de productivdad, sobre todo en aquéllos sectores o ramas manufactureras que han crecido a pesar de la crisis: productos alimenticios, bebidas y tabacos, sustancias químicas, derivados del petróleo, caucho y plásticos, industrias metálicas básicas, productos metálicos, maquinaria y equipo, etc.

Sin embargo, esta elevación del nivel de productividad en el país, no ha sido acompañada por un incremento en el nivel salarial. La caída salarial se mantiene como política gubernamental no sólo en el contexto de una economía en crisis, con baja productividad e inflación galopante, sino en la actualidad, en condiciones distintas.

El discurso oficial crea la esperanza de que los salarios subirán en términos reales con el crecimiento de la economía y el incremento de la prdctividad. Dichas condiciones se están cumpliendo, y sin embargo la caída salarial continúa según mostramos en la siguiente Gráfica:.

Fuente: "La política salarial en el modelo neoliberal 1976-92" Alberto Arroyo economista UAM.

PRODUCTIVIDAD/SALARIOS REALES



Con desequilibrios la economía mexicana está creciendo y como puede verse en la gráfica, la productividad de la industria manufacturera crece, pero los salarios del sector siguen deteriorándose.

Esto es así porque la política salarial en México se concibe como una variable dependiente y subordinada al objetivo de aumentar la competitividad de nuestras exportaciones, al de atraer inversión extranjera y controlar la inflación. Por ello creemos que el Tratado de Libre Comercio fortalecerá la tendencia a la caída salarial en lo general, aunque en contraparte, la necesidad de crear un mercado creciente a las exportaciones norteamericanas en nuestro país, debería llevar a aumentar el poder de compra de sectores medios mexicanos. Es falso pues, como propagandiza el gobierno mexicano, que el Tratado de Libre Comercio traerá una elevación necesaria del nivel de ingresos de la mayoría de la población.

LA PRODUCTIVIDAD Y LOS SALARIOS FRENTE AL TLC

Trabajadores mexicanos miembros del sindicalismo independiente, hemos presentado las siguientes exigencias centrales en relación al tema de Productividad y Salarios, para ser incluídas como parte importante del Acuerdo Paralelo en materia Laboral, que hoy negocian los gobiernos de la Región.

De manera resumida, estas exigencias son:

1) Participación de los trabajadores en los procesos de cambio.

2) Que la productividad forme parte de un proceso de racionalización integral y no responda simplemente a una sobreexplotación de la fuerza laboral.

3) Que los beneficios obtenidos con la productividad sean compartidos con los trabajadores.

4) Que se integren a los planes de productividad acuerdos de formación profesional.

5) Que los nuevos esquemas de desempeño no afecten la integridad física y mental de los trabajadores.

6) Que se generen condiciones estructurales y sociales para que la productividad permita un desarrollo integral de la sociedad. Condiciones tales como libertad de organización, democracia y beneficios a la comunidad.

Con salarios tan insuficientes como se paga a los trabajadores mexicanos, no es posible hablar de un compromiso sobre productividad, ya que la angustia cotidiana por sobrevivir, los obligo a tener varios empleos, a buscar trabajo extra o a dejar la capacitación como un lujo que en estos momentos no se puede tener. Bajos salarios y subordinación organizativa son impedimentos estructurales ante un necesario esfuerzo de productividad social que debería comprometer a la sociedad en su conjunto.

Los sindicatos mexicanos estamos por la productividad, pero exigimos que se den las condiciones mínimas para que ésto sea posible.

México, D.F., agosto de 1993.-

WHAT IS THE FAT?

The Authentic Front of Labour (FAT) is a national Mexican organization of working men and women, united, pluralistic, democratic and independent. Since our founding in 1960, we have struggled for justice, freedom and democracy. As a worker's organization, we hold our own points of view, independent of government, employers and political parties.

FAT members are industrial workers, peasants and farm workers, agricultural and industrial cooperative members and neighborhood community activists. We are dedicated to helping our diverse membership work together and learn from each other.

The FAT services its members with training and education programmes, research, legal and technical counsel. We provide our affiliated organizations and individual members with the tools they need to fight effectively in the workplace and in the community to improve their lives. FAT members have negotiated some of the best collective agreements in Mexico, which are models for other unions.

The FAT priorizes training programmes with women union and cooperative members. We also offer our services to new organizing drives and efforts to build democratic and independent unions. The FAT is not just a union, we are also a social movement, active in the workplace, in the countryside and in the neighborhood.

In a country where most unions and popular organizations are linked to the government and the ruling political party, the FAT stands out as an independent labour organization. Yet, the FAT takes clear positions on issues effecting working people, and works in the political arena to defend workers' interests. The FAT promotes an active style of unionism with the goal of building a socialist and self-managed society.

We believe that it is important for our goals to be reflected in our daily practice. We are a democratic organization that relies on the active participation of our members in all areas of decision-making. We promote unity and solidarity among our membership, in Mexican society in general, and in international relations. The FAT is a founding member of the Mexican Action Network on Free Trade and participates on its steering committee.

The FAT has offices in the following Mexican states: Yucatan, Nuevo Leon, Guanajuato, Morelos, Chihuahua, Coahuila, Durango, the State of Mexico, Veracruz, and the Federal District. The FAT national office is located at:

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Mr. PETERSON. We have a vote, I see. I think what we will do here is try to get in a few minutes of questions and then we will have to recess briefly for a vote, and then we will come back and hear the next panel of witnesses.

Your description of this new productivity accord, or whatever it is called, sounds very good, but it sounds too good to be true. They have had another agreement called "el pacto" that has been in operation longer, is that not true?

Mrs. LUJAN. You are right.

Mr. PETERSON. And would you describe how that agreement has been enforced and how it keeps wages below the level of inflation? Can you explain to us how that works?

Mrs. LUJAN. That wage stability pact or that stability pact doesn't have legal weight, either. It is an accord between the private enterprise and the government.

Mr. PETERSON. And this new deal that they have put together in 1992 is the same kind of thing, it sounds good but there is no teeth in it or no weight of enforcement?

Mrs. LUJAN. Yes.

Mr. PETERSON. Could you describe to us how the wages and living conditions of Mexican workers have changed since the economic collapse of 1981?

Mrs. LUJAN. The wages in general, they say, have fallen 63 percent over this period. They say that the wage level in Mexico now is parallel to what we had before the revolution. The government entities are dealing with some statistics that are considered very inexact and very questionable. When they say that most Mexican workers do not obtain the lowest minimum wages, in other words, given an idea that the wages are in general above the minimum, that the industrial wages are quite a bit above the general wage, and that it therefore is less of a loss in wages. But even according to government statistics, more than 20 percent of those who are employed earn these general minimum wages, which are now about $5 per day for an 8-hour workday. And the industrial wages are no higher than $10 per day.

Mr. PETERSON. Thank you.

I would like to, without objection, put into the record a recent article from the Sheybogan Wisconsin Press comparing the workers making $10.50 a day in Monterrey, Mexico, with ones doing an identical job for the same company in Wisconsin that is making $116 a day.

The Mexican worker lives with his mother, according to this article, has no car, doesn't eat much bread because it costs $1 a loaf. The American worker has a car, shops at the grocery store, and pays a home mortgage.

[The article follows:]

SHEYBOGAN, WI PRESS
Monday, July 26, 1993
article 1

Luis Montoya, meet Dick Klabechek

Kohler workers in Mexico, U.S. face separate realities

By JOHN FAIRBANKS
OF THE PRESS STAFF

Economic ties are already growing between Mexico and Wisconsin

2nd in a series

Luis Montoya and Richard Klabechek work for the same company, but they regard each other as competitors.

Montoya (a pseudonym, because he feared "problems" if he spoke to a journalist) and Klabechek have similar jobs with Kohler Co., the Sheboygan County-based manufacturer of bathroom fixtures, small engines and other products.

Montoya works in the Kohler maquiladora assembly plant in Juarez, a dusty village just outside Monterrey in east central Mexico; Klabechek works about 1,300 miles north, in the company's home factory in Sheboygan County.

Maquiladoras are foreign-owned plants in Mexico that assemble products for export. For decades, outsiders were not allowed to own factories in Mexico. The federal government created the maquiladora system to give foreigners an opportunity to invest in the country and to provide jobs for workers who would otherwise head north across the Rio Grande.

Both men work in a pottery, making ceramic bathroom fixtures. The factories are hot, and the work is strenuous. Montoya makes 32 pesos a day, about $10.50, depending on the exchange rate, which works out to about $1.25 an hour. That's double the average wage in maquiladora plants around Monterrey. In Klabechek's department, the base wage is $7.90 an hour, but with incentives, the average pay is about $14.50 an hour, or $116 a day.

Montoya knows his wage is a good one for the Monterrey area, and he gets some additional benefits, like $9 a week in food coupons. Still, he doesn't enjoy the same standard of living as Klabechek, whose pay is well above the average $12.10 per hour wage for Sheboygan County. Klabechek, for example, can shop in a grocery store, buy a car, pay a mortgage.

Because prices for groceries, cars and houses in Monterrey are close to those in Sheboygan, Montoya is not so free. A loaf of bread costs $1. A bottle of Dos Equis beer served in a restaurant is $2. A decent apartment will fetch $400 a month. A new Dodge Shadow sedan lists for $16,000. Montoya eats cheaply, lives with his mother, and rides a bus to work.

"It's a job," he said. "The company pays a little better than the others, but there's no money left to save."

Montoya said he reads the

Workers

Continued from Page A1

newspapers and is familiar with the debate over the proposed North American Free Trade Agreement. Supporters say it will increase business, and, therefore, his wages. Asked what he thinks about the treaty, he smiled ruefully.

"It would be very good if they'd pay me the same money they would pay in the U.S.A.," he said.

A Kohler Co. official said the wage differences were a factor in the company's decision to build its new $42 million maquiladora assembly plant in Juarez, but added that there were more important considerations.

"There's no question that (wage) rates are lower down there," said Joseph W. Harbrecht, president of the company's Plumbing and Specialty Products, North America group, "but that wasn't the driver. Mexico is a very vibrant market, and you want to be near your customers."

Labor costs were less of a consideration in Juarez, Harbrecht said, because the plant is the most automated of any Kohler pottery-making facility.

Because Kohler's Juarez plant is a maquiladora, though, the Mexican government allows the company to sell only 25 percent of its production in Mexico. The rest must be exported. Harbrecht said Kohler's plant is "a launching pad" for future global competition.

"We're not competing in Mexico with product made from that plant," he said, "but we're looking to enter the Mexican market with Kohler products made in the U.S."

Montoya, who has worked in factories in Mexico and the U.S. for 20 years, knows he and Klabechek are, in a sense, rivals. You don't need to be a Nobel laureate in economics to understand that wage differences between Mexico and the United States are a draw for American companies.

"It's a big difference (in wages)," Montoya sighed. "Factories come here because the government gives them incentives like that. The people there (in Kohler, Wis.) need jobs, too, but I think honest commerce is good."

Klabecheck accepts the real ity of the situation.

"You can't blame Kohler fo having to build a plant in Mex co," he said. "We did not los any jobs per se here in Kohler but if the Mexican plant ha not been built, we could hav had 300, 400, 500 jobs here i Wisconsin. The only thing w can do is try to produce th best product possible and kee our standard of living.

"If people here want jobs fo their kids," he added, "the better buy American."

— by JOHN FAIRBANKS

Mr. PETERSON. Mrs. Lujan, do you think this is an accurate description of the situation, the difference between the Mexican and United States workers' situation?

Mrs. LUJAN. Your information is correct in terms of the plight of the Mexican worker.

Mr. PETERSON. Thank you.

Mr. McHugh, do you have any questions for the witness?

Mr. MCHUGH. Well, I don't know that we have a lot of time, Mr. Chairman.

Mr. PETERSON. We have maybe 5 minutes. We will try to——

Mr. MCHUGH. First of all, can I assure Mrs. Lujan that her English is much better than my Spanish.

Mrs. Lujan, in your written submission, under section 3, you talk about, "using all the above mentioned methods, productivity in Mexico has increased."

I am interested in the statement in the next paragraph where you say, "The government continues to advocate wage suppression as a deliberate policy that is enforced regardless of the level of inflation." How is that deliberate policy enforced, and what are the components of that policy?

Mrs. LUJAN. It has to do with the question of legal procedures, and in Mexico there is a tripartite commission which sets the wage level's limits each year. And this commission is controlled by the executive to the labor secretary. And it is this labor secretary which, according to the parameters set by the executive, sets the raises, the increases, year by year. And this understanding that this increase in the minimum wage levels sets the tone for the contracting, the wage contracts—so that means that all of the increases, all of the wage increases which fit into the collective bargaining arrangement, must have the approval of the labor secretary.

Those agreements between companies and trade unions which would set any wage level above those put as ceilings would not be accepted by the labor secretary. We have the experience of revisions of contracts, contracts being reviewed, in which the increase in wages is the thing that is going to be reviewed and studied by the labor secretary.

And another part of the rise in wages is going to have to be dealt with under the table. This year, for example, several companies suffered fiscal repression because they had given wage increases above the official levels set.

Mr. PETERSON. I am sorry?

Mr. MCHUGH. No, I understand.

Mr. PETERSON. We thank you very much, Mrs. Lujan, for being with us. We will excuse you now.

The subcommittee will be in recess for about 10 minutes. Then we will call our next panel of witnesses when we get back.

[Recess taken.]

Mr. PETERSON. The subcommittee will be back in session.

Our second panel of witnesses are Harley Shaiken, professor at the University of California at San Diego, and Alan Reynolds, senior fellow and director of economic research at the Hudson Institute.

We welcome both of you and appreciate you taking the time to be with us today. It is a custom in the Government Operations Committee to swear in all witnesses so that we don't discriminate against any of them.

Do either of you have an objection against being sworn in.

Mr. SHAIKEN. No.

[Witnesses sworn.]

Mr. PETERSON. Mr. Shaiken, we will begin with you and then we will hear from Mr. Reynolds before we have questions. Both of you have written statements which we will make a part of the record in their entirety. You can feel free to summarize those and shorten them up.

We are also going to ask that Mr. Shaiken's study entitled "Myths About Mexican Workers" and Mr. Reynolds' paper prepared for the June 28, 1993, NAFTA summit both be entered into the record, without objection.

With that, we again welcome you to the committee and appreciate you taking the time. We look forward to hearing your testimony.

STATEMENT OF HARLEY SHAIKEN, PROFESSOR, UNIVERSITY OF CALIFORNIA AT SAN DIEGO

Mr. SHAIKEN. Thank you very much. I am very pleased to be here. I think these hearings are both very important and at a particularly opportune time. Given what else is happening in Washington this week, it might be one of the few times a discussion on NAFTA seems harmonious by comparison.

What I would like to do is talk briefly about the nature of Mexican manufacturing and the relation of productivity to wages in Mexico and the impact that could very well have on jobs, communities, and the industrial base in the United States.

I would like to do that by discussing three myths we have been repeating so often we often think they are true by force of repetition, but I think lead to a highly distorted, if not dead wrong, perception of what is taking place in Mexico.

The three myths are: First, that the Mexican export sector is limited to low productivity, low technical operations, that is there is a natural fit between the Mexican and United States economies. The United States is high technical, Mexico is low technical. They easily fit automatically.

Myth two, low wages are no longer important in high tech manufacturing. Finally, myth three, that world class wages in Mexico will automatically follow in the wake of increasingly world class productivity.

Just the opposite is the way in the Mexican export sector today, particularly the most advanced plants in that export sector. Here we see first-world productivity and quality which is combined with artificially depressed Third World wages. If that situation persists, then I think the clear and immediate impact it could have on the U.S. economy would be widespread and extremely harmful.

First, I would like to deal with myth one, that Mexico's export sector is limited to labor-intensive, low technical, low productivity operations. What is frequently quoted in this regard is the average productivity of Mexican manufacturing. Now that is an important

number, but it tells us very little about the decision any firm is going to make about moving to Mexico. When I get up in the morning, I don't look for the average weather in the United States to determine what I am going to wear, I look for the weather in the city where I live, what I am likely to expect.

I think here one has to look for not the average productivity, including 1920's technology in small shops south of Mexico City, but what the productivity is likely to be in a new plant in the north of Mexico because that is the basis on which the decision will be made.

In trying to evaluate that, I would like to briefly discuss the experience of two major investments in the 1980's. This is not speculative about what could happen. It is what has already happened.

Both of these plants, an auto engine plant and an auto assembly plant, are more complex in terms of manufacturing than 75 to 80 percent of other production processes. In other words, if you can site this effectively in Mexico, it would be a lot easier to site washing machine production, et cetera.

The first example, the auto engine plant, went online in 1982, a $250 million investment. Within 2 years of operation, it had 85 percent of the machine efficiency of a U.S. plant making an identical engine with very similar technology.

Within 8 years, it had 97 percent of the machine efficiency of the U.S. plant. This machine efficiency is by far the most important measure in a capital-intensive plant. If you want to look at direct labor productivity in the Mexican plant, within 2 years, engines per person, the company's principal measure was 93 percent of U.S. levels.

The starting wage in that plant today is $1.89 an hour for production workers. The average production worker wage is a little over $2 an hour. The quality of the engines in the last year of production on the first engine, 1991, was 32 percent higher than the identical engine made in the United States, which was a very high quality engine.

The second example is an automobile assembly and stamping plant, a $500 million investment that went online in 1986. Within 3 years of operation, it was producing the second highest quality small car sold in the United States regardless of where the vehicle was manufactured, significantly higher quality than many far better known Japanese name plates like the Nissan Sentra or the Mazda 323.

Thirty percent of the parts of this car by value were Mexican in the initial 3 years. The most recent figure of a Ford Escort and Mercury Tracer which are made in this plant show that of 46 assembly plants in North America, the Hermosillo assembly plant is virtually tied for fifth place in terms of quality.

If we look at the direct labor productivity, measuring it by the number of vehicles per person, the plant has a productivity of about 15 percent lower than a plant making the identical vehicle near Detroit. But, in fact, even that is misleading because the Detroit plant is much more automated. It is hard to justify a $125,000 robot when you are paying $2 an hour wage cost in a highly productive plant like this.

These two plants, both combined initial investment of the $750 million, are now going through major expansions. In Hermosillo, an additional $300 million expansion has been completed, and in the engine plant, a $550 million expansion.

The key issue? With their kind of productivity and quality, what do you need? Do you need a ready supply of skilled workers? No. Both these plants hire very young workers, average age early 20's. One hundred percent had never been in an auto factory before. What they had was a solid basic education, largely between junior high and high school, and then they were provided with very fine, extensive training because training costs mirror labor costs. Training costs are also one-seventh or one-eighth of what United States labor costs are, which in fact allow far more extensive training in Mexico.

It is this combination that has resulted in these stellar results. Not just in these two plants, but across the Mexican export sector. The Mexican Government predicts that engine exports will double from $1.2 billion in 1991 to $2.4 billion in 1994.

Other projections show that by the year 2000 Mexico could be exporting 1 million vehicles a year, giving it a total vehicle capacity about the size of Canada's auto industry today. So these are hardly isolated examples.

This brings me to the second myth: Low wages are unimportant in high tech manufacturing. I think that a very oft repeated statement was uttered or at least popularized by Carla Hills who said, "if wages were the only factor, many developing countries would be economic superpowers."

Of course, wages are not the only factor. There are a lot of factors. When productivity and quality are as high as the two examples I just stated, wages can be decisive.

I would like to go through a quick calculation for an auto assembly plant to show the order of magnitude and importance that low wages, given this productivity, might have. The most productive auto assembly plant in the United States today takes 20 hours to assemble a car. Assuming the Hermosillo plant is about 20 percent less productive, it would take 24 hours to assemble a car which is actually fairly close to the actual numbers, within 1 hour. At $40 an hour total compensation, that is $800 assembly cost in the direct labor for a vehicle in the United States. At $5 an hour total compensation, that is double the hourly wage in Mexico; it is $120. You are talking about almost a $700 difference for direct labor costs and final assembly. But that is only direct labor.

If you factor in the difference for salaried workers, it grows greater. But that is only the plant.

If you look at the supplier chain, which would obviously be attracted, you would be replicating that labor cost throughout the hours to manufacture the car. We are looking at a very significant difference.

There are, of course, countervailing costs; transportation costs are often higher. But transportation costs would be significantly affected by the current proposed North American Free Trade Agreement. They will be lower. And as suppliers move to Mexico, those transportation costs go down as well.

This brings me to the final myth, and I think in many ways the most important: That world class wages will automatically follow in the wake of world class productivity.

Now, economists generally argue that wages reflect productivity levels. They do, in introductory economics courses. They do not very often in the real world. And they certainly do not in Mexico because in the examples I just gave, two auto assembly plants with virtually identical productivity and quality, workers in one plant—United States—have a compensation of $40 an hour and the workers in the other plant—Mexico—has a compensation of $5 an hour.

Does that reflect the productivity of the two plants? Obviously not. If you were thinking about making an investment, would that influence your choice? Obviously yes. But it would go beyond influencing the choice. It would also, and has, exerted a chilling effect on wage levels in the United States. Simply the threat of moving to Mexico really raises the spector of job loss in an economy where jobs have proven increasingly difficult to find.

What is the relation between productivity and wage levels in Mexico over the last 12 years? If we set 1980 equal to 100 and we look at Mexican productivity in real pesos, we index it in real pesos, by 1992, the index is up to 130. If we do the same with real total compensation and manufacturing, wages and benefits, the index goes from 100 in 1980 to 77 in 1992. It dipped even lower at the trough of Mexico's worse economic collapse in history.

But today the average manufacturing worker in Mexico, total compensation is simply three-quarters of what it was in 1980. In fact, that may understate the case. If we look at direct wages for production workers, they are 57 percent in the first 2 months of 1993 of what they were in 1980.

The meaningful comparison, however, this comparison shows that Mexican wages have been depressed. One important factor in that depression is the lack of labor rights, a highly controlled labor movement and government policies that have sought to attract investment at the expense of wages as well as employer collusion in directly setting wages in many major export sectors, particularly the maquiladoras.

But the meaningful number for United States investment is not real wages in Mexico but what United States firms have to pay for Mexican wages compared to their other choices. In 1980, Mexican compensation and manufacturing was 22 percent of U.S. levels. In 1992, it was 15 percent of U.S. levels. In the maquiladora sector, in 1980, Mexican compensation was 14 percent of U.S. levels. In 1992, it was 10 percent of U.S. levels.

So last year if a U.S. manufacturing company wanted to make a choice, it would have to pay over $16 an hour compensation in the United States, $5 an hour compensation in Korea, or $2.35 total compensation in Mexico. In the maquiladora sector, it is $1.65 an hour total compensation.

The net result of where this goes is not hard to figure out. It exerts a threat to jobs and it exerts an even greater threat to wage levels within the United States because even moving a single plant in a given industry to Mexico can produce a highly chilling effect.

In conclusion, the issue is not whether or not we ought to have economic integration with Mexico. We have economic integration

with Mexico. That will continue. Nor is the issue Mexican development. Mexico ought to develop, and many of these prospects are very promising for the future.

The issue is the basis on which that integration and development takes place. If we simply ignore the fact that Mexican wages are not related to productivity because of a lack of labor rights, then we are talking about a free trade agreement that accelerates the process without paying any attention to the basis on which that process rests.

Wage determination in Mexico could ultimately become a powerful factor in wage determination in the United States, so the real issue is ensuring before we accelerate economic integration that worker rights and labor rights are protected in both countries as a foundation for prosperity in both countries and to allow workers on both sides of the border to share in what they produce.

Thank you.

Mr. PETERSON. Thank you, Mr. Shaiken.

[The prepared statement of Mr. Shaiken follows:]

Productivity and Wages in High Tech Mexican Manufacturing

Professor Harley Shaiken
University of California, San Diego

Testimony before the
Employment, Housing, and Aviation Subcommittee
US House of Representatives
August 5, 1993

Productivity and Wages in High Tech Mexican Manufacturing

Harley Shaiken
University of California, San Diego

A great deal of the debate over the North American Free Trade Agreement (NAFTA) is based on a fundamentally flawed understanding of Mexico's growing export sector and its relation to wage levels, jobs, and the manufacturing base in the United States. I would like to discuss three myths that have achieved wide currency in large part because they are repeated so often with so little real exploration.

- Myth 1: Mexico's export sector is limited to labor-intensive, low-tech, and low-productivity operations.

- Myth 2: Low wages are no longer important in high-tech manufacturing.

- Myth 3: World class wages in Mexico will automatically follow in the wake of world class productivity.

As a result of these myths, many observers have argued that "a free-trade agreement with Mexico would further encourage [a] natural international division of labor" (Council of Economic Advisors, 1991:253) laying the basis for an automatic win-win situation in which "manufacturing competitiveness encourages productivity and higher wages" (ibid). The reality is far different than this rosy scenario indicates. Mexican export plants in industries from automobiles to consumer electronics have matched or exceeded US quality and productivity levels, an achievement that should justifiably make Mexicans proud. First world productivity and quality, however, have been combined with artificially depressed third world wages. This combination means not only that many Mexicans cannot enjoy the

fruits of their labor but that many US workers may face a powerful threat to their own jobs and wage levels. At risk are not simply $6 an hour jobs sewing blue jeans but $19 an hour jobs machining complex parts.

Myth 1: Mexico's export sector is limited to labor-intensive, low-tech, and low-productivity operations.

Overall, Mexican labor productivity in manufacturing is considerably lower than in the US. This broad average, however, tells us little about Mexico's export sector and its potential since the average combines antiquated mom-and-pop machine shops for the domestic market with state-of-the-art color television assembly plants for export. Instead, average productivity tells us where the Mexican manufacturing base has been, not what its capability is or the directions in which it might be developing. Moreover, firms do not site production facilities based on the average productivity of an economy but rather on what levels of efficiency they are likely to obtain in the types of operations they are setting up.

With this last point in mind, let's consider three complex manufacturing operations—not because they are typical of the Mexican manufacturing base—but rather because they indicate what that base is capable of. Much of manufacturing would present considerably fewer problems in terms of locating in Mexico than these examples. In these examples, three sets of plants in the US and Mexico produce identical or very similar products—automobile engines, finished vehicles, and auto parts. Although in the same industry, the manufacturing processes in each of these plants is quite different and represents a broad range of production technology and experience applicable to many other industries as well. In each case, the Mexican plant achieves quality and productivity either higher than or

comparable to the US plant. In some cases, quality in the Mexican plant exceeds both Japanese and US levels.

In the first case, I compare a $250 million auto engine plant in Mexico that went on line in 1982 to a plant in the US producing the same engine, with similar technology. The average age of the Mexican work force was in their early twenties and 100 percent had never worked in an auto plant before. Moreover, the plant was built in an agricultural and administrative area with little comparable industry to either draw from or support the plant. In the key area of machine yield—a measure of the productivity of technology in a high tech plant—the Mexican plant achieved 85 percent of US performance in less than 2 years and 97 percent after eight years in the engine's last year of production. The Mexican plant actually surpassed the US plant on some complex machining lines in as little as 18 months from start-up. The product quality of the Mexican plant was even more impressive. It surpassed the American plant in four of the six years for which data is available (1986-1991) and exceeded US quality by 32 percent in the last year of production. Not surprisingly the US automaker is plowing over $500 million into the expansion and retooling of the Mexican plant .

The second example is Ford's $500 million Hermosillo Stamping and Assembly plant. The plant brings together 2,000 hourly workers and state-of-the-art computerized manufacturing technology to stamp, weld, paint, and assemble 165,000 Ford Escorts and Mercury Tracers for export to the US and Canada. Three years after the plant went on line, the Mercury Tracer it produced was the second highest quality small car sold in the US market, outdistancing such Japanese-assembled standbys as the Nissan Sentra and Toyota Corolla. The plant switched over to assembling a more complex Ford Escort after a $300 million expansion and changeover in 1990. At the end of

1992, the Mexican-assembled Escort had higher quality than 5 out of 8 Japanese-owned assembly plants in the US and was virtually tied for fifth place out of 46 assembly plants in North America. In fact, the quality in the Mexican plant was 8 percent higher than a plant building the identical vehicle in the US. Labor productivity—the number of workers required to assemble a car—ranked 12 out of 33 auto assembly plants for which data were available in North America. The Mexican plant needed about 15 percent more labor hours by this measure than the US plant building the same vehicle, a remarkably low number since the Mexican plant uses less automation and thereby lowers its capital costs.

Finally, consider a small auto parts producer, Breed Technologies, a manufacturer of complex electronic sensors for auto airbags. After setting up a maquiladora or assembly plant in the late 1980s, the president commented that "almost immediately, we had higher productivity in Mexico than we had in New Jersey," adding that "I also won't hesitate to build any new plants we might need for products which have significant labor content."

Are these success stories isolated cases? Not by a long shot. While not typical of Mexico's industrial base, these plants represent the cutting-edge of Mexico's expanding export sector. All five automakers operating in Mexico—GM, Ford, Chrysler, VW, and Nissan—built or expanded export-oriented engine plants in the last decade. These plants exported almost 1.3 million engines in 1992, making Mexico among the world's largest exporters of auto engines. The Mexican government predicts that engine exports will double from $1.2 billion in 1991 to $2.4 billion annually by 1994. Mexico's auto exports—250,000 cars to the US in 1992—could rise to total exports of almost one million passenger cars a year by the year 2,000, the vast majority to the US. Some analysts predict that Mexico will produce 2 million vehicles

annually by the year 2, 0000, a production value greater than Canada's in 1992. And, these results are replicated in consumer electronics, computers, and a variety of other high tech industries as well.

Low wages are also reflected in low training costs, allowing advanced manufacturing plants to invest heavily in training. A growing flow of technical and engineering school graduates provides a potential core for a much wider diffusion of high tech production. Mexico had over 340,000 engineering students enrolled in 1990, almost as many as the US, and graduated 200,000 vocational students in 1989-90.

Myth 2: Low wages are no longer important in high-tech manufacturing.

Many analysts are fond of repeating a statement popularized by former United States Trade Representative Carla Hills who said "if wages were the only factor, many developing countries would be economic superpowers." As Alan Reynolds put it "if wages were all that mattered, regardless of the quality of human capital, then all the best factories in the world would have relocated to Somalia, Bangladesh and Haiti many decades ago." Wages, of course, are never the only factor but when quality is high and productivity reaches a certain threshold—certainly the case on both counts in Mexico's export sector—then wages can be decisive.

Consider the case of the automobile industry. The most advanced assembly plant in the US requires about 20 hours to assembly a car while the most advanced Mexican plant needs about 24 hours. Total compensation—wages and benefits—at the Big Three averages about $40 an hour while in Mexico it is in the range of $5 an hour. This means that the direct labor cost in the US for assembling a car is $800 at the most advanced plant while in Mexico it is $120, a savings of $680 per vehicle on direct labor alone. If

comparable cost savings on two or three hundred salaried workers in an assembly plant are factored in the cost savings would rise even more.

The auto assembly plant, however, is only the final point of the manufacturing process. As component plants and suppliers move to Mexico, the assembly plant savings could be repeated throughout the production chain. Overall, the average compensation cost in the motor vehicles and equipment sector in the US was almost eight times the Mexican average in 1991; $24.21 in the US compared to $3.33 in Mexico, offering a powerful incentive to relocate production.

What about other expenses, aside from labor costs? Many of these are likely to be less in Mexico as well. "When I factor in other non-labor costs—less heat, cheaper land and cheaper construction—there is no question that Mexico's lower labor costs are decisive," John Pearlman, chairman of the Zenith Electronic Corporation told the New York Times earlier this year.

An area where costs are likely to be higher in Mexico is transportation, but even here Mexico may prove to have some surprising advantages. In an auto assembly plant, for example, shipping costs have two components: shipping parts to the plant and transporting the finished car to the dealer. If the supplier base remains primarily located in the US then there would be a transportation premium shipping parts to Mexico compared to a US plant. The supplier base, however, is likely to gravitate to Mexico under NAFTA which would reduce these costs considerably. Moreover, a plant in northern Mexico would have a significant transportation cost advantage in shipping a car to Los Angeles (or anywhere in the huge markets of California and Texas) compared to a plant in Detroit.

Myth 3: World class wages will automatically follow in the wake of world class productivity.

Economists generally argue that wages reflect productivity levels. "Mexican wages, like other low prices, have been low for a reason," according to Alan Reynolds, "Mexican productivity is low." While this may be indisputably true in introductory economics classes, the issue is more complex in the real world in general and in Mexico in particular. Mexico's economic collapse in the 1980s followed by government austerity measures, state strategies to attract investment, and a highly controlled labor movement have served to depress wages far below their traditional levels. Moreover, these conditions have dragged down wages in the highly productive export sector far below what workers might otherwise be able to achieve in this area. According to Business Week the current government is continuing many of these policies: "to smother inflation and preserve Mexico's huge labor cost gap with US and other producers, Salinas fixes salaries through a complex business-labor agreement that's know as *el pacto.*"

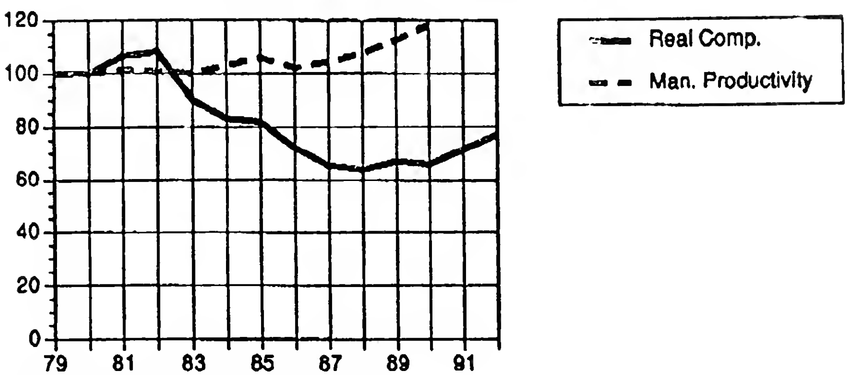
Mexico's highly controlled "official" labor federation *Confederación de Trabajadores de México (CTM)*, has served more to implement government policies than as an independent advocate for workers throughout the tumultuous eighties and into the nineties. Moreover, most workers are left with few alternatives to this situation, given the state-dominated labor relations system combined with truncated labor rights in practice.

While independent worker organizations are often stifled, employers often have unprecedented ability to control wages in key sectors. In maquiladora centers, for example, firm representatives meet regularly to set compensation ranges. Rather than letting wages rise to combat turnover—the way an open labor market would theoretically operate—these associations

fix wages and let turnover fall where it may. In addition, maquiladoras often refuse to tolerate even government-dominated labor organizations. "Americans looking for a preview of North American free trade look first to the border," Business Week tells us "where they see industries that prevent their low-wage workers from organizing, while Mexico City looks the other way."

The results of economic trauma, government policies, and constricted labor rights has been a downward pressure on wages despite gains in productivity. Preliminary estimates show a rise in Mexican labor productivity in manufacturing to 130 in 1992 from a base of 100 in 1980. Despite these gains, Mexican real compensation in 1992 was little more than 3/4 of what it had been in 1980. (Real compensation rose to 108 in 1982, plunged to 64 in 1988, and has climbed to 77 in 1992.)

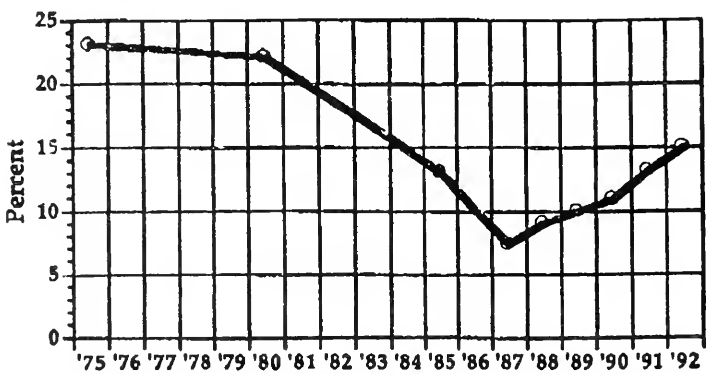
Figure 1
Productivity and Real Hourly Worker Compensation
Mexican Manufacturing 1979-1992



Manufacturing Productivity: 1980=100
Real Compensation: 1979=100

The gap in hourly compensation costs in manufacturing between Mexico and the US has widened considerably since 1980. Mexican compensation was 22 percent of US levels in 1980, nose-dived to 7 percent in 1987, and was only 15 percent of US levels in 1992. In the rapidly growing maquiladora industry, total compensation was 14 percent of US levels in 1980 (in dollars) and 10 percent in 1992, despite an explosive growth in employment in the maquiladoras from 120,000 to 500,000 workers during this period. In contrast, the comparative wages of Asian Newly Industrializing economies rose from 12 percent to 30 percent of US levels.

Figure 2
Mexican Hourly Compensation Costs in Manufacturing
as a Percentage of United States Costs
1975-1992



Source: Bureau of Labor Statistics, Office of Productivity and Technology, March 1993

Wages in the cutting-edge export plants are pulled down by the same forces depressing Mexican manufacturing wages in general. Consider two

auto assembly plants, both producing for the US market. If productivity and quality are comparable, yet total compensation in the US is 8 or 10 times Mexican levels, are we to assume that this will have no impact on where future investment takes place or on wage levels in the US?

Mexican real wages in manufacturing began rising in 1988, dipped in 1989, and have risen since 1990 and, some analysts argue, could continue to rise. *Banco de Mexico* data, for example, show that real compensation rose by 15 percent between 1990 and 1992 while productivity rose by 12 percent. This upward movement, however, is tempered by two factors. First, the drop was so steep in the 1980s that considerable ground must be covered just to get up to 1980 levels. Second, the institutional factors that decoupled wages and productivity in the first place remain in place and could slow or reverse future wage gains. As the American and Mexican economies become more interdependent, artificially depressed Mexican wage levels could exert a strong downward pressure on wages in the US, given Mexican productivity in the export sector and the size of the current wage gap.

The movement of even a limited number of plants to Mexico could press down on wage levels over far broader economic sectors through a powerful demonstration effect. A single plant that moves to Mexico in a given firm or industry would have a chilling effect on wages and working conditions in the plants that are not moved, exerting downward pressure through example.

A 1992 *Wall Street Journal* poll underscored this point. One-quarter of almost 500 corporate executives polled admitted that they are either "very likely" or "somewhat likely" to use the treaty as a bargaining chip to hold down wages, and about 40 percent indicated that they might move at least some production to Mexico within the next several years. An Office of

Technology Assessment report also concludes that "a NAFTA could reinforce U.S. employers' efforts to compete using low-wage rather than high-wage strategies, increasing direct competition with Mexico and other developing countries on the basis of wage levels."

Conclusion

At issue in the current debate over NAFTA is not economic integration with Mexico—that already exists and will continue to expand—but the basis on which an accelerated integration should take place. Mexico has demonstrated in a broad variety of industries and manufacturing processes an important high tech manufacturing capability. At the same time, powerful institutional pressures—government policies and a lack of labor rights among them—have weakened the link between rising productivity and wages. The danger is that a high skill, high wage strategy in the US could be undercut by the availability of high skill, low wage strategy in Mexico.

The economic integration now being put forward rests on over a decade of major institutional change in Mexico concerning the structure of Mexican markets and expanding investor rights. While NAFTA negotiations were under way during these last several years, these investment guarantees have been expanded. The purpose of these unilateral and negotiated changes in Mexico were not simply to lower trade barriers but to guarantee investment and to harmonize standards in these areas. Unless a similar process takes place to insure more uniform labor standards, then wage levels and working conditions, like water, will flow downhill. The result would be growing polarization both in Mexico and the United States rather than realizing the promise a more balanced economic integration could achieve.

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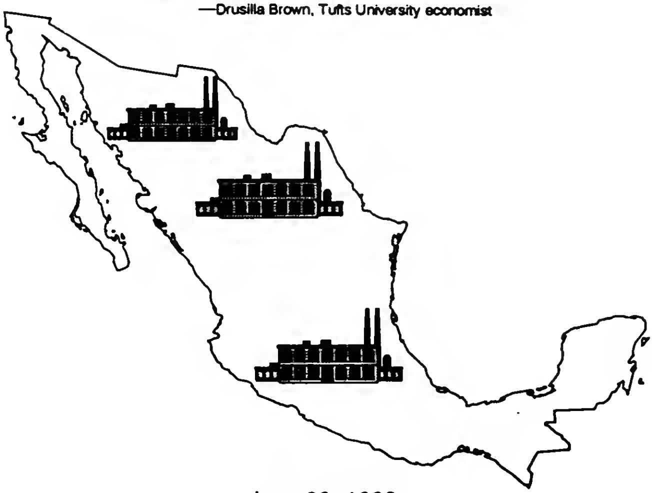
MYTHS ABOUT MEXICAN WORKERS

"A free-trade agreement with Mexico would further encourage [a] natural international division of labor....This gain in manufacturing competitiveness encourages productivity and higher wages."
—Economic Report of the President, 1991

"The U.S. will lose some jobs but they are mostly jobs that require little or no skill."
—Drusilla Brown, Tufts University economist



June 29, 1993

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MYTHS ABOUT MEXICAN WORKERS

Introduction

Much of the debate concerning the North American Free Trade Agreement (NAFTA) is based on an outdated vision of the Mexican economy. This vision portrays Mexico as an industrial backwater, a place in which exports are constrained by low-technology manufacturing and low levels of worker productivity.

This view of Mexico, rooted in the past, is simply not consistent with what is taking place at a new generation of production sites across the country. Moreover, it leads to a distorted perception of the near term development of the Mexican economy and the potential impact of proposed changes in the trade laws and the trading relationship.

Mexico is demonstrating an ability to match or in some instances even surpass first world standards for quality and manufacturing efficiency. This accomplishment, combined with the fact that facilities which produce these products continue to pay third world wages, has serious implications for jobs, wage levels, and the manufacturing base in the United States.

As a result of outdated assumptions, however, many observers argue that Mexican manufacturing forms part of a "natural international division of labor" (Council of Economic Advisors, 1991: 253) in which the U.S. concentrates on high tech output, Mexico on low tech production. The low tech jobs that migrate from the U.S. to Mexico, in this view, will make the high tech jobs that remain more competitive. Any economic damage that results will be limited to jobs at the low end of the ladder. Lustig, Bosworth, and Lawrence cite several studies reflecting this position which contend that "the gains to better-skilled American workers will be offset by some losses to those not as skilled (1992: 3)." Tufts University economist Drusilla Brown concurs, admitting, "the U.S. will lose some jobs but they are mostly jobs that require little or no skill (1993: C 12)."

Will the negative fallout from growing economic integration be confined to low skill, low wage jobs in the U.S. or could the best manufacturing jobs be threatened? In this paper, I explore this question by addressing three broad issues:

- To what extent can high tech production be successfully located in Mexico?

- How important are low wages in advanced manufacturing?

- What has been the relation between wages and productivity in Mexican manufacturing, particularly the export sector?

I conclude, based on extensive field work in Mexico, that the most advanced Mexican plants have demonstrated a strong high tech capability. While these plants are far from typical, they indicate the direction in which Mexican manufacturing is headed. These factories, in industries from consumer elec-

factories, in industries from consumer electronics to automobiles, achieve quality and productivity levels which, at times, rival the best facilities in Japan. And they achieve these results in from 18 months to three years of start-up with young, highly motivated workers who have a basic education and little industrial experience.

While many factors influence where a plant is built, I argue that low wages, combined with the high quality and productivity of Mexico's new generation of advanced plants, can serve as a magnet capable of attracting highly sophisticated production. Although real wages in Mexico have risen since 1990, the experience of the last decade indicates a shattered, and now sluggish, link between expanding productivity and rising wages. In fact, Mexican manufacturing worker real compensation in 1992 was only about three-quarters of what it had been in 1979, despite significant gains in productivity. The danger is that controlled labor markets and artificially depressed Mexican wages will perpetuate income polarization in that country–retarding the expansion of the domestic market–and press down on wages within the U.S.. In this regard, highly skilled $18 an hour manufacturing jobs in the U.S. would be as vulnerable as less skilled $6 an hour occupations.

What Is Mexico's Industrial Capability?

Much of the public discussion over NAFTA has been shaped by the results of quantitative models built on the assumptions of neoclassical economics. While these models can certainly play a useful role, their often conflicting results must be evaluated with considerable caution for two reasons.[1] First, neoclassical economics does not address the far-reaching institutional changes currently taking place. As a recent report by the Office of Technology Assessment put it, "OTA's analysis indicates that the neoclassical arguments for free trade are of minor significance....This is particularly so because NAFTA comes when the United States is in a transition from a national, mass production economy to a continental and global economy–a historical and institutional context ignored by mainstream free trade models(1992: 6)." Second, the models make arbitrary, simplistic, and misleading assumptions. These assumptions frequently rule out the possibility of substantial investment diversion to Mexico or the potential impact of NAFTA on three key labor market variables. The models typically assume that wages will rise in Mexico in tandem with productivity growth, that wage comparisons with Mexico will not further bend (or break) the wage-productivity link in the U.S., and that U.S. unemployment will not rise. Moreover, the models often implicitly assume that Mexico has limited industrial potential by maintaining that its products do not directly compete with those produced in the U.S.[2]

The suspect nature of this last assumption is indicated by the changing mix of Mexico's exports to the United States. In 1980, Mexico exported almost $13 billion of merchandise to the U.S., over half of which

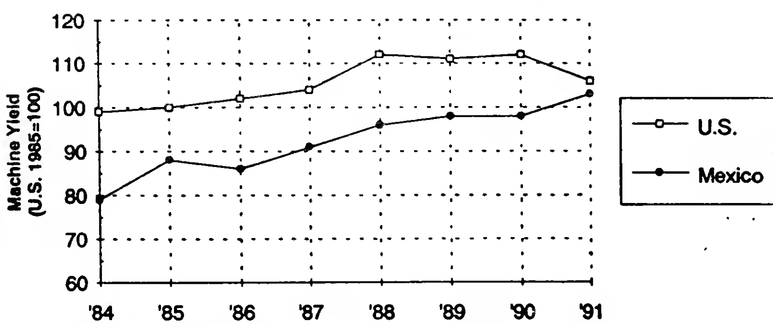
was oil and other fuels. More sophisticated manufacturing categories–machinery, transport equipment, electrical machinery, and telecommunications and office equipment–together accounted for only slightly more than 16 percent of the total. By 1991, exports jumped to $32 billion, fuel's share plummeted to about 15 percent, and the share of the sophisticated manufacturing groups listed above grew to almost half (GAO, 1992: 24-27).

This aggregate economic data, however, only provides the broad outlines of the far-reaching changes in Mexico's industrial capability. To understand the extent of these changes, one also has to look at the character of production in individual industries or even plants. By "kicking the tires" of Mexico's most advanced plants, a sense of that country's industrial capability emerges that challenges the dated assumptions of many econometric models. Three questions are central: first, how does quality and productivity compare to similar plants in the U.S. or Japan; second, how long does it take to achieve high performance; and finally, what worker qualifications are necessary?

The automobile industry is one of the most advanced export-oriented sectors in Mexico today and automobile engine production is among the most complex and close-tolerance manufacturing operations in this or any other major industry. In fact, the term automation was reportedly coined to describe the transfer line technology of auto engine plants in the aftermath of World War II. All five major automakers currently operating in Mexico–Ford, GM, Chrysler, Volkswagen, and Nissan–opened or expanded high-volume export-oriented engine plants in the 1980's. These plants exported almost 1.3 million engines in 1992, making Mexico the world's largest exporter

FIGURE1

Machine Yield on Four Principle Machining Lines*: U.S. and Mexcian Automobile Engine Plants, 1984-1991



*Cylinder Head, Cylinder Block, Camshaft and Crankshaft

of automobile engines (Commercio Exterior, 1993: 406; Aufenacker, 1993: 4).

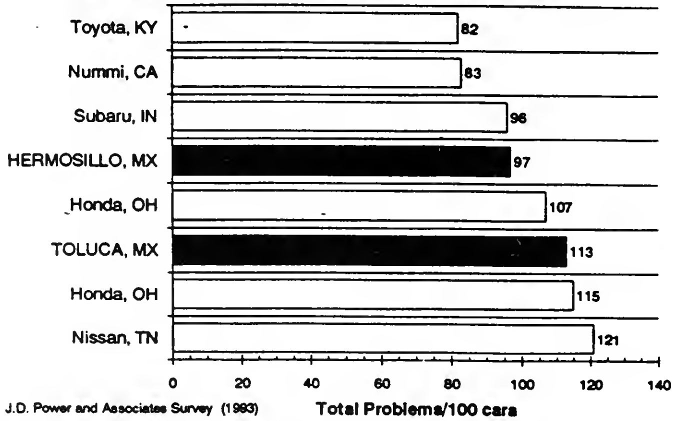
I compared the most advanced of these facilities–a $250 million plant opened by a U.S. automaker in northern Mexico in 1982 and capable of producing 400,000 engines a year–with a U.S. plant producing the same engine with similar though somewhat less advanced technology (Shaiken and Herzenberg, 1987; Shaiken, 1993). The results of this comparison are striking. In the critical area of machine yield–a measure of the productivity of technology in a capital intensive plant–the Mexican plant achieved 85% of the performance of the U.S. plant after less than two years of operation (1984), 89% over an eight year period (1983-1991), and 97% in the last year of production on the same engine (1991) (Shaiken, 1993: 18-19). (Figure 1) On some of the more complex lines the Mexican plant exceeded the performance of the American plant in as little as 18 months from the start of operations. Moreover, product quality in the Mexican plant surpassed the American plant in four of the six years for which data is available (1986-1991) and in the last full year of production exceeded the quality of the U.S. plant by 32% (Shaiken, 1993: 22). Not surprisingly, this U.S. automaker is in the midst of a $550 million reworking and expansion of this plant which will ultimately be able to supply more than 400,000 units a year of a far more sophisticated engine to the North American market (Shaiken 1993: 11).

Nissan has also achieved high quality and productivity in a manufacturing complex in Aguascalientes, several hundred miles north of Mexico City. The plant achieved the lowest number of defects on engines checked at the end of the line of any of the company's plants worldwide (Shaiken 1993: 26). Nissan has announced that the Mexican plant will produce all engines for the U.S.-assembled Altima, one of the company's most important products in the hotly competitive U.S. market. The company projects engine exports will reach an annual rate of 120,000 by late 1993 (Maskery, 1993: 1). General Motors has achieved similar high quality results at its Toluca engine plant, a one hour drive from Mexico City. The company reports that it has conducted 33 "zero defect" audits in a row in this plant (Sanchez, 1993: 5). Given these successes, it comes as little surprise that the Mexican government predicts that engine exports will double their 1991 levels to $2. ÷ billion annually by 1994(Saavedra, 1993: 28).

The results are equally impressive for automobile assembly. Mexico exported over 250,000 cars to the U.S. in 1992, placing third behind Canada and Japan in units exported (USITC, 1993: 2). The most sophisticated automotive assembly plant in Mexico is Ford Motor Company's $500 million assembly and stamping plant in Hermosillo. About 2,000 hourly workers, over 120 robots, and dozens of computerized systems combine to produce up to 165,000 cars a year, all for export to the

FIGURE 2

New Car Initial Quality Survey (1992)
Mexican and Leading Six Japanese-Owned Plants in U.S.



Source: J.D. Power and Associates Survey (1993)

U.S. and Canada. In 1989, three years after the plant went into operation, it was producing the second highest quality small car sold in the U.S. market, virtually tied with the Honda Civic for first place, and outpacing far better known rivals such as the Nissan Sentra and the Toyota Corolla, built in highly regarded plants in Japan (Shaiken, 1993).

Hermosillo switched over to building a new, more intricate model of the Ford Escort and Mercury Tracer in 1990, after a $300 million expansion and changeover. At the end of 1992, the plant placed sixth out of forty-six assembly plants in North America in terms of quality, according to a survey carried out by the authoritative J.D. Power and Associates. The quality measure, defects per hundred vehicles after three months of service, ranged from 71 in the highest rated plant to 250 in the lowest. Hermosillo scored 97, besting the 105 score of a plant also producing the Escort near Detroit. Even more surprising, Hermosillo bettered five of the Japanese-owned assembly plants in the U.S.–some by a considerable margin–and narrowly trailed the other three (Figure 2).[3] In fact, Hermosillo's performance indicates that any of these Japanese-owned plants, set up in the U.S. in the 1980's, could have been successfully sited in Mexico.[4]

The quality story is similar for less automated auto assembly plants as well. A Chrysler assembly plant in Toluca, for example, came in twelfth in the Power survey. Moreover, the General Motor's Ramos Arizpe assembly plant won the J.D. Power "Bronze Award in Quality" in 1992 (Sanchez, 1993: 6). This assembly plant, as well as the company's Mexican engine plant, "ap-

pear consistently among GM's highest quality rated engine and car plants in North America," according to Richard C. Nerod, a GM vice president in charge of its Latin American operations (1993: 18). Some analysts predict that Mexico could export almost one million passenger cars annually by the year 2000 (Leos, 1993).[5]

Quality in consumer electronics products is also high. Sony operates high tech color television assembly plants on both sides of the border, one in Tijuana and the other in a northeastern suburb of San Diego. The Tijuana plant has won Sony worldwide quality awards for several years running and the performance of both plants is so close that Sony does not break down warranty costs separately (Shaiken, 1993: 26). At a nearby Sanyo television plant, the vice president of Mexican operations maintained that the plant had comparable quality to Sanyo plants in the United States and Japan but at much lower wages (Meyer, 1993: B-13).

Small- and medium-sized firms have been as successful in transferring production as corporate giants. Breed Technologies, a manufacturer of complex electronic sensors for automotive airbags, set up a maquiladora, or assembly plant, in the late 1980's. "Within nine months of breaking ground on the Matamoros plant, we were assembling parts in a new 100,000 square foot facility. Almost immediately, we had higher productivity in Mexico than we had in New Jersey," according to the company's president, and all this for wages that were less than $1 an hour at the time. "I also won't hesitate to build any new plants we might need for products which have significant labor content," he added (Breed, 1993: 7, 13).

Advanced services as well as manufacturing are also being moved to Mexico. One of the more dramatic examples is now under construction on 100 acres adjacent to the Tijuana airport: a giant maintenance and repair station for state-of-the-art jet aircraft. Matrix Aeronautica, a joint venture of Hong Kong and Tijuana investors, is in the process of building the first of three cavernous hangars, each capable of housing two Boeing 747-400's and one DC-10 aircraft at the same time and designed to accommodate even larger 600 person aircraft still in the design stage. The facility will initially perform aircraft safety checks and repairs but will graduate into more sophisticated retrofitting. Ultimately, the investment may total $250 million and employ as many as 3,000 people (Lindquist, 1991: A-1).

Not all firms that relocate to Mexico succeed. In fact, there have been some spectacular failures, after which firms have moved their plants back to the U.S. What the above examples illustrate, however, is that the capability of moving advanced plants to Mexico has been repeatedly proven in complex, high tech industries. To achieve these impressive results, companies tend to follow a similar pattern in setting up plants: they combine a cadre of experienced managers from their global operations, a highly motivated work force, and effective training. In the case of the Hermosillo plant, Ford

TABLE 1

Educational Background of Hourly Workers (Percent of Initial Workforce)

Plant	Elementary	Junior High	Technical	High School	University
Auto Engine		30.0	16.0	47.0	7.0
Auto Assembly		8.5	10.0	50.0	31.5
Television Assembly*	52.0	42.0		6.0	

*Not initial workforce; data as of February 1, 1992.

brought in about eighty auto industry veterans initially, mostly from the U.S. and Canada, but within three years of operation had pared the number to three North American managers on the shop floor.

What levels of experience and education do the workers require? The companies tend to hire workers without previous industrial experience to avoid what they perceive as "preconceptions" about how a plant should be run. In the auto engine plant the average age of the initial workers hired was in the early-twenties and all lacked previous auto industry experience. Thirty percent had only a junior high education and 63 percent had completed high school or a technical education. At the auto assembly plant the initial cohort had much higher levels of education but the company felt that this contributed to turnover and has since achieved high quality by hiring high school and junior high graduates. The electronics plant had a much lower educational profile, with over half its workers having only elementary educations (Shaiken, 1993: 34).(Table 1)

Some advanced manufacturing plants in Mexico invest heavily in training. While much attention has been paid to the huge wage gap between the U.S. and Mexico, less noticed is the fact that low wages translate into low training costs. Consequently, high tech firms do not require an existing skill base to set up production: they are able to train novice workers at a fraction of U.S. costs. At the Hermosillo plant, for example, the initial new hires received a minimum of four months of intensive training before starting work, whether they ultimately attach door handles on the line or troubleshoot computerized robots. As a result, the plant has an unusually deep skill base. This compares to about one or two weeks of training provided for production workers at Japanese-owned assembly plants in the U.S.. Moreover, as the experience of the engine and assembly plants indicate, skill development can take place in a relatively short timeframe (Shaiken, 1993).

Training such as this requires a solid basic education, even if only at the junior or senior high school level. Workers who have these qualifications are in the top third of Mexico's workforce, a group *Business Week* numbers at about 10 million strong (Baker, et al., 1993: 86).[6] Although Mexico's educa-

tional system is starved for resources–it spends $70 per elementary school student annually compared with over $4,000 in the U.S.–in 1989-90 it turned out close to 200,000 vocational school graduates. In addition, Mexico had 342,000 engineering students enrolled in 1990, almost as many as the U.S. (OTA, 1992: 100-105). A stream of technical and engineering school graduates provides a potential supply of skilled workers and future managers and could create a critical mass for a much wider diffusion of advanced manufacturing. Today many technical and engineering graduates are looking for jobs to match their skills. "They are people who are overqualified for the jobs they now can get," the director of the Chihuahua Institute of Technology, a post-secondary technical school, remarked about his institution's graduates. "The supply of skilled workers is still greater than the demand for their skills (Uchitelle, 1993B)."

How Important Are Low Wages In High Tech Manufacturing?

Two arguments are used to minimize, or even dismiss, the importance of low wages as a magnet for high tech manufacturing. First, many economists and trade experts argue that the low wages of developing economies simply reflect low productivity. It could prove to be a fool's bargain to site high tech manufacturing in Mexico, in this view, because the penalties of low productivity could swamp the benefits of low wages, resulting in high unit cost. If a worker who is paid $1 an hour makes one widget per hour, then the unit labor cost per widget is $1. If a worker is paid $10 an hour and makes 20 widgets per hour, however, than the unit cost is cut in half to $.50 despite much higher wage rates. Second, some observers, such as Peter Drucker, maintain that wages are "increasingly irrelevant" in high tech production in any case because "blue-collar labor no longer accounts for enough of total costs to give low wages much competitive advantage (Drucker, 1988)." Both arguments fail to recognize

TABLE 2
Hourly Labor Cost Comparison
Hypothetical U.S. and Mexican Auto Assembly and Stamping Plants

	UNITED STATES	MEXICO
Hourly Employment	2,000	2,400
Annual Hours Per Worker	2,000	2,000
Total Hours	4,000,000	4,800,000
Hourly Compensation	$40.00	$5.00
Annual Hourly Labor Costs	$160,000,000	$24,000,000

Even though productivity and quality are world-class, workers remain low paid, creating a powerful lure for advanced manufacturing.

The importance of wage costs stands out in automobile assembly, which combines highly automated and labor-intensive processes even in the most advanced American or Japanese plants. Assume an American and Mexican plant, each producing about 200,000 vehicles a year. The U.S. plant achieves this output with 2,000 hourly workers who put in 2,000 hours a year or 4,000,000 annual labor hours. The Mexican plant needs 2,400 workers or 20 percent more than its American counterpart to meet this production goal (a conservative assumption given the equal or better productivity reported on above), resulting in 4,800,000 annual labor hours. If we assume a compensation cost of $40 an hour for wages and benefits in the U.S. plant (Ford's current cost is over $39), the annual wage bill would be $160,000,000, while at $5 an *hour* the Mexican plant would have an hourly labor cost of $24 million, an annual difference of $136 million (Table 2).[7] Even in a plant whose initial cost is $500 million, savings of this magnitude stand out.

Another way to view the importance of hourly labor costs is by looking at the number of hours that are required to assemble the vehicle. The most advanced assembly plants in the U.S. today need about 20 final assembly hours per car. At the compensation costs cited above, the hourly labor cost in an advanced U.S. plant would be $800 while in a Mexican plant requiring 24 hours it would be $120, giving the Mexican plant a $680 per vehicle cost advantage on final assembly alone. If assembly time is reduced to 15 hours in the American plant and 18 in the Mexican plant, among the best times in Japan for subcompacts, the savings is over $500 a car.[8] Finally, another way to look at the potential labor cost advantage is that the annual savings per worker would be $70,000 (for a 2000 hour year) at these compensation costs.

The Mexican labor cost advantage is even more decisive when the labor cost saving of 200 or 300 salaried workers in an assembly plant are also factored in. While the wage ratio between the U.S. and Mexico is not as great for white-collar workers, it nonetheless often equals 4 to 1.

The auto assembly plant is only the tip of the auto manufacturing chain. As component plants and suppliers move to Mexico, the savings achieved in assembly plants could be replicated throughout the production process. Chrysler, for example, maintains that each vehicle it produces in the U.S. embodies 120 labor hours. Many of these hours would be at Chrysler's 1992 average compensation rate of $39.64, the rest at a lower compensation rate for suppliers. In either case, the potential labor savings in Mexico is considerable. Overall, the average compensation cost in the motor vehicles and equipment sector in the U.S. was almost eight times the Mexican average in 1991; $24.21 in the U.S. compared to $3.33 in Mexico, offering a powerful incentive to relocate production.

Other expenses are also likely to be less in Mexico. "When I factor in other non-labor costs–less heat, cheaper land and cheaper construction–there is no question that Mexico's lower labor costs are decisive," John Pearlman, chairman of the Zenith Electronic Corporation maintains (Uchitelle, 1993A: 14F). Mr. Pearlman should know since Zenith employs about 20,000 people in Mexico. The vice president of Sanyo's television operations in Mexico added, "if your business is fairly labor-intensive and you have more than 500 workers, it's probably a good move to come to Mexico (Meyer, 1993: B-13)."

While high tech manufacturing plants in Mexico are highly automated, they tend to be less automated than their American or Japanese counterparts. The reason is that they only automate in areas where quality is an issue, the manufacturing process requires it, or the technology would have to be redesigned to be more labor intensive. Otherwise, it is more cost effective to have workers instead of robots. This more labor-intensive approach can significantly lower the cost of capital for a new plant and the operating expenses over time. Comparing Breed Technologies' Mexican production process for airbag sensors to its competitors in the United States, its president commented, "our approach to assembling the product costs is much less capital intensive and is more flexible than the more automated approach used by TRW and Siemens (Breed, 1993: 8)." Breed was so much more effective, in fact, that it drove its much larger competitors from the business.

An area where costs are likely to be higher in Mexico is transportation. In an auto assembly plant, these costs are composed of two elements: shipping parts to the plant and shipping finished vehicles to the dealer. If a supplier plant is in the midwestern United States then it will obviously be more expensive to ship a part to Mexico than to Detroit.[9] NAFTA, however, is likely to result in more supplier plants relocating to Mexico because of the liberalization of Mexican investment rules in auto parts and because of the increased security of investment in Mexico. If the supplier is in Mexico, or even the southern U.S., then shipping costs would be considerably reduced for a Mexican assembly plant compared to its American counterpart. The cost of transporting the finished car from the plant to the dealer depends on the geographical relation of the two. In some cases, it would be more expensive to ship to the U.S. from Mexico but the huge markets of Texas and California, among others, are considerably closer to northern Mexico than to Detroit.

The importance of low labor costs was underscored by Collectron, an Arizona-based management firm that sets up maquiladoras and has aided companies such as Xerox, General Electric, and ITT in establishing Mexican operations. In a promotional letter, the director of marketing extolls the possible savings. "Companies that relocate to Mexico come primarily to take advantage of the low labor rates," he writes. "Our clients report that they have achieved savings between $10,000 and

$20,000 per employee." He then adds that "the workforce is unspoiled and can be trained to a client's specifications quickly and efficiently and superior productivity can be achieved by proper management (Rigoli, 1993)."

What Is the Link Between Rising Productivity and Wage Levels in Mexico?

Economists generally argue that wages reflect productivity levels. Hufbauer and Schott, for example, contend that "the U.S. worker earns high wages because of his high output, which in turn reflects his work skills, his complement of sophisticated capital equipment, and the highly articulated infrastructure of the U.S. economy (13)." Carla Hills, former United States Trade Representative, concurs, maintaining that "if wages were the only factor, many developing countries would be economic superpowers (quoted in Hufbauer and Schott, 1993: 12)."

In the case of Mexico the issue is more complex. The traumas of Mexico's economy in the 1980's–high underemployment, a severe debt burden, a low productivity traditional sector–combined with institutional factors such as government austerity measures and a tightly controlled labor movement have depressed wages in manufacturing in general and in the highly productive export sector in particular. This combination of economic and institutional factors snapped the link between rising productivity and improved wages in the 1980's as real earnings plummeted. Historically, the productivity-wage link has allowed workers in the United States and elsewhere to earn enough to buy what they produce, achieving middle class lifestyles in the process and fueling an expanding consumer market.

Although Mexico has made extensive strides toward privatization and liberalized markets since the mid-1980's, the state remains a much more visible presence when it comes to labor and labor costs. The government achieves its austerity and inflation goals through the "Pact for Stability and Economic Growth," or *el pacto* as it is often referred to in Mexico, a state-dominated alliance incorporating business, labor and peasant organizations (Alvarez, 1991). Introduced in 1987 as a weapon to combat inflation and restore economic stability, this mechanism continues to serve a broad variety of economic functions, including enhancing Mexico's investment climate by keeping wages low. "To smother inflation and preserve Mexico's huge labor cost gap with U.S. and other producers, Salinas fixes salaries through a complex business-labor agreement that's known as *el pacto*," according to *Business Week* (1993: 85).

The terms of *el pacto* are carried to the unionized sector by Mexico's highly controlled labor movement. The "official" labor group, *Confederacion de Trabajadores de Mexico* (CTM), is an arm of the ruling party and, during the economic debacles of the last decade, served more to transmit government policies than as an independent advocate for workers. Although Mexico has

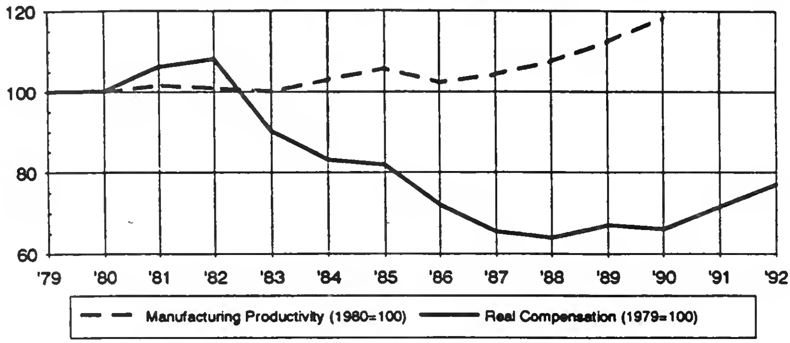
strong labor legislation in many areas, the state-dominated labor relations system combined with truncated labor rights in practice makes independent organization or opposition difficult and, at times, dangerous. Workers at Volkswagen saw how the system worked in summer-1992 when a bitter strike was concluded after "Salinas gave VW permission to rip up the union contract," according to *Business Week* (1993: 90). VW terminated its 14,000 workers, instituted a new contract, then rehired the workforce minus 300 dissidents.

As a result of government and CTM policies, the link between achieving high productivity and receiving commensurate wages doesn't hold among plants within Mexico, even in highly visible, bellwether industries such as automobiles. When the auto firms built a new generation of export-oriented factories in northern Mexico, the new plants paid significantly less than the older, lower productivity plants near Mexico City, a relationship that still holds in some plants (Middlebrook, 1991: 284). A high-productivity export-oriented Nissan plant in Aguascalientes, for example, currently pays assemblers $1.20 an hour while an older Nissan plant in Cuernavaca, less productive and oriented towards the domestic market, pays almost 50 percent an hour more.[10] Rather than the older plants pulling the wages of the newer plants upward, the opposite has occurred. A bitter 61 day strike was concluded at the Ford Cuatitlan plant near Mexico City in late 1987 by terminating the entire work force (with the behind the scenes approval of the government and the union) and selectively rehiring 2,500 people at wage levels below a new assembly plant in the north (Middlebrook, 1991: 284).

In the maquiladora industry employer federations conspire to hold wages down. In large maquiladora centers such as Tijuana, employers meet regularly to agree upon salary ranges and to avoid engaging in competitive wage bidding for workers. Rather than raising wages to combat turnover–the way a labor market theoretically operates–these associations fix wages and let turnover fall where it may, often as high as 10 to 15 percent a month. In addition, maquiladoras often refuse to tolerate even government-controlled unions. "Americans looking for a preview of North American free trade look first to the border," *Business Week* concluded, "where they see industries that prevent their low-wage workers form organizing, while Mexico City looks the other way (1993: 91)."

The result of economic pressure, government policies, and constricted labor rights has been a severe downward pressure on wages in manufacturing despite gains in productivity. Although Mexican manufacturing was hammered by economic turbulence during the 1980's, labor productivity grew at a 1.7 percent annual rate, rising from an index of 100 during 1980 to 118 in 1990 (BLS-B, 1992). (Preliminary estimates indicate a further 12 percent productivity gain from 1990 to 1992).[11] Despite these productivity gains, the real hourly compensation of Mexican production workers in manufacturing fell precipitously dur-

FIGURE 3
Productivity and Real Hourly Worker Compensation Mexican Manufacturing, 1979-1992



Source: Bureau of Labor Statistics, Office of Productivity and Technology, August, 1992.

ing the 1980's. Indexing this compensation to 100 for 1979, it inched up to 108 in 1982, plunged to 64 in 1988, and climbed to 77 in 1992 (BLS-A, 1993). In other words, by 1992 the hourly wage was little more than three-quarters of what it had been thirteen years earlier. If real compensation had tracked productivity through 1990, the last year for which complete data are available, compensation would have been almost 80 percent higher[12] (Figure 3).

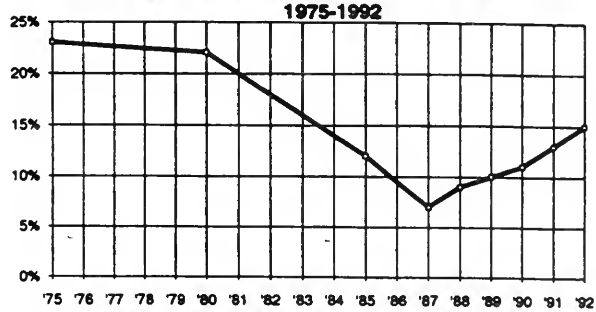
Comparing hourly compensation costs in manufacturing between Mexico and the U.S., we find that the gap has widened considerably since 1980. Setting U.S. compensation to 100, we find that Mexican compensation was 22 percent of U.S. levels in 1980, this plummeted to 7 percent in 1987, and was only 15 percent of U.S. levels in 1992. During this same period, the comparative wages of Asian Newly Industrializing economies rose from 12 percent to 30 percent of U.S. levels (BLS-C, 1993: 5). (Figure 4).

In the maquiladora industry hourly compensation costs also still trail their 1981 peak, despite rising productivity and a soaring demand for labor. The number of workers employed has more than quadrupled from about 120,000 in 1980 to over 500,000 in 1992 and the number of plants has jumped from 620 to over 2000. Given this rapid expansion in the demand for workers, one would expect wages to be driven upwards. Instead, total compensation costs were lower in 1992 than they were in 1981, $1.64 compared to $1.68 (BLS-A, 1993). (Figure 5).

Wages in advanced Mexican plants–which attain world-class productivity and sell their products in the U.S. market–are pulled down by the same forces that depress Mexican manufacturing wages in general. The result is that plants producing

FIGURE 4

Mexican Hourly Compensation Costs in Manufacturing as a Percentage of United States Costs 1975-1992

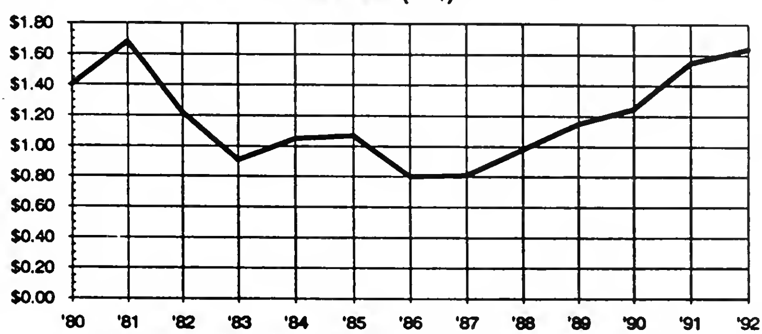


Source: Bureau of Labor Statistics, Office of Productivity and Technology, March, 1993.

the same product, for the same market, at similar productivity and quality levels have significantly different wage costs in Mexico and the United States. This phenomenon is most visible by looking at individual plants rather than by broader industry averages. Consider the two Sony television assembly plants mentioned earlier, one a maquiladora in Tijuana and the other part of a manufacturing complex fifty miles north near San Diego. They assemble similar television models, have comparable quality and productivity, and nearly equal transportation costs. Yet, hourly wages in the Mexican plant are less than $1 an hour while wages in the San Diego plant are about $10 an hour. Or consider the Hermosillo Assembly plant in Mexico and its companion plant

FIGURE 5

Hourly Compensation Costs for Production Workers in Maquiladoras, 1980-1992 (US$)



Source: Bureau of Labor Statistics, Office of Productivity and Technology, March, 1993.

near Detroit. Once again quality and productivity are similar yet hourly wages in Mexico are about $2 an hour compared to $18 an hour in the U.S..

Mexican real wages in manufacturing began rising in 1990 and, some analysts argue, could continue to rise. This upward movement, however, is tempered by two factors. First, the drop was so steep in the 1980's that considerable ground must be covered just to return to 1980 levels, which themselves were low compared to the U.S.. Second, the important institutional factors discussed above that decoupled wages and productivity in the first place remain in place and could slow or reverse future wage gains. As the American and Mexican economies become more interdependent, artificially depressed Mexican wage levels could exert a strong downward pressure on wages in the U.S., particularly given the size of the current wage gap. Some observers view this process as having a desirable dimension. Hufbauer and Schott, for example, observe:

> In some industries and in some products, U.S. wages are higher than U.S. productivity can justify when compared with the juxtaposition of Mexican wages and productivity, for example. Those activities will tend to migrate from the United States to Mexico (1993: 13).

Hufbauer and Schott, in advance no doubt of what many U.S. firms will do, are using Mexican wages as a yardstick to measure whether U.S. wages are too "high." In response to the charge that U.S. firms will seek to ratchet down U.S. wages by threatening to move to Mexico, Hufbauer and Schott continue, "we would not vilify private firms that balance wage rates against labor productivity when selecting plant sites (1993: 14)." The fundamental flaw in this argument is that it assumes that wages bear some relation to productivity in Mexico's export sector which the above data indicate is a highly questionable assumption. Wages do not achieve equilibrium in an open labor market but rather are depressed as a result of institutional factors. Instead of an invisible hand guiding wages in a free labor market, an all-too-visible arm–in the form of government policies, constricted labor-rights, and a surplus labor force–drags wages down. If Mexico becomes the standard by which to measure U.S. wages, the activities that "will tend to migrate from the United States to Mexico (1993: 13)" could be those at the core of the manufacturing base and the U.S. middle class, among the most highly paid production jobs in the economy.

These developments in Mexico come at a time of growing income polarization in the U.S.. Overall, U.S. workers have seen real hourly earnings in manufacturing slip by over 6 percent since 1979 (BLS-A, 1993). The bottom end of the scale has fallen even more dramatically as the proportion of full-time workers unable to support a family of four above the poverty line rose from 12 to 18 percent during the 1980's (OTA, 1993: 3). And the ability of organized labor in the U.S. to exert countervailing pressures to these trends is also limited given the slippage of union representation to less than 12 percent of the private sector work force.

The movement of even a limited number of plants to Mexico could press down on wage levels over far broader economic sectors through a powerful demonstration effect. A single plant that moves to Mexico in a given firm or even industry would have a chilling effect on wages and working conditions in the plants that are not moved, exerting downward pressure through example.

A 1992 *Wall Street Journal* poll underscored this point. One-quarter of almost 500 corporate executives polled admitted that they are either "very likely" or "somewhat likely" to use the treaty as a bargaining chip to hold down wages, and about 40 percent indicated that they might move at least some production to Mexico within the next several years (1992, R-7). An Office of Technology Assessment report also concludes that "A NAFTA could reinforce U.S. employers' efforts to compete using low-wage rather than high-wage strategies, increasing direct competition with Mexico and other developing countries on the basis of wage levels."(1993: 7)

On What Basis Should Expanded Economic Integration Take Place?

Mexico has demonstrated the capability to be a high tech manufacturing base and this capability is likely to expand considerably in the years to come. At the same time, powerful institutional pressures–goverment policies and a lack of labor rights among them–have served to undermine the link between productivity and wages. Why should companies invest in a high skill, high wage strategy in the U.S. when a high skill, low wage strategy is available in Mexico? Under these circumstances, the factors that drag down wages in Mexico could also pressure wages in the U.S. and unravel programs that seek to enhance the U.S. manufacturing base.

In the context of an expanding Mexican domestic market and economic growth in the United States and Canada, increased economic integration could benefit all three countries. To achieve these benefits, however, will require effective, independent mechanisms that harmonize labor and environmental standards as well as their enforcement upward as a precondition for more rapid economic integration. Unless meaningful provisions in a North American Free Trade Agreement serve to repair the linkage between productivity rise and wage gain in Mexico, the resultant pressures may result in U.S. manufacturing firms exporting jobs and importing wage levels.

Measures which seek to foster higher labor standards and wages in Mexico will not eliminate Mexico's potential for growth. Indeed, they could maintain social stability and workplace cooperation that will yield a long-term movement towards first world wages. Moreover, restoring the link between wages and productivity in Mexico will expand the consumer market, sustain a more equitable pattern of development, and benefit both the U.S. and Mexico.

Notes

[1]For further discussion of quantitative models see "Economic Models as Predictors of NAFTA Impacts," Appendix 5A in U.S. Congress, Office of Technology Assessment, U.S.-Mexico Trade: Pulling Together or Pulling Apart?, and James O. Stanford, "C.G.E. Models of North American Free Trade: A Critique of Methods and Assumptions," Testimony to the U.S. International Trade Commission Public Hearing on Economy-Wide Modeling of the Economic Implications of Free Trade, Investigation No. 332-317, April 1992.

[2]James O. Stanford of the Brookings Institution is currently developing a model which relaxes the common assumptions concerning full-employment and acknowledges that U.S. and Mexican-produced goods may compete, rather than simply complement each other. In addition, the model places a heavier emphasis on the way institutions affect income distribution.

[3]This data is based on the J.D. Power and Associates "1992 Early Buyer and New Car Initial Quality Study." It is the company's policy not to publish the names of plants in the bottom half of the survey.

[4]In terms of assembly plant productivity, one rough measure of efficiency is the number of vehicles produced per worker. Using this index, out of 31 U.S.-owned automobile assembly plants in North America, Hermosillo ranks twelfth (Harbour, 1993: 45). This measure, however, understates Hermosillo's potential since the low wage rates discourage the use of automation which would likely raise the plant's output per worker.

[5]These Ciemex-Wefa projections also call for the import of 180,000 passenger cars in the year 2000. The Mexican government predicts that exports will reach 700,000 units by 1999.

[6]The average educational level for Mexicans over 15 years old was 6.3 years in 1989-90 (OTA, 1992: 101). According to the OTA, "because no more than 50 to 60 percent of Mexican children enroll in secondary school, compared with 95 percent here, the disparity in workforce skills between Mexico and the United States will not close in the near future. But education is only a starting point. On the shop floor and in the front office, practical skills and experience count for more than years of schooling (100)."

[7]In 1992, the total annual compensation cost for hourly workers was $39.64 at Chrysler, $39.16 at Ford, and $42.21 at General Motors (see annual reports).

[8]Japanese plants that achieve these productivity levels are far more capital intensive. The considerable additional cost of this technology is not included in these calculations.

[9]The cost of shipping components over long supply lines such as this can be considerable but the Japanese-owned plants in the U.S. seem to do well, despite the fact that their supply lines stretch to Japan itself.

[10]The Aguascalientes plant is organized by an affiliate of the CTM while the Cuernavaca plant is represented by an independent union. The $1.76 figure for Cuernavaca is an average of labor grades 5-8, in which most workers fall, and was negotiated in April 1993. The $1.20 rate for Aguascalientes is an average of grades 2a and b for operators in the engine plant and was negotiated in January 1993. Information on wages from phone interviews with unions in both plants.

[11]This productivity gain is calculated from a different data series published by *Banco de Mexico*. The *Banco* measures average productivity per worker by setting 1988 equal to 100. The Index then rises to 108.6 in 1990 and 121.3 in 1992, for a 12 percent gain (*Banco de Mexico*, 1992: 24).

[12]If we use *Banco de Mexico* data for real compensation, with 1988 set at 100, compensation went from 112.4 in 1990 to 129.3 in 1992, for a rise of 15 percent. Since productivity rose 12 percent during this period, according to the *Banco* data series, real wages would have been 74 percent higher than they were in 1992, if wages had followed productivity. This number is derived from the Bureau of Labor Statistics data from 1980 to 1990 and the precentage increase of the *Banco de Mexico* data from 1990 to 1992.

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Mr. PETERSON. I want to ask one thing. On the direct costs, you said it was $700 difference?

Mr. SHAIKEN. Yes.

Mr. PETERSON. In Mexico, do they have to pay health care? Isn't there also a difference between health care in this country? Isn't there a lot more health care in a car here than in Mexico?

Mr. SHAIKEN. Yes. That is a significantly higher figure in the United States. That figure on health care is part of the total compensation cost of $40 an hour. I have added that in. Health care on both sides are accounted for. In fact, all costs are accounted for on both sides.

Mr. PETERSON. Mr. Reynolds, we appreciate your being with the committee.

STATEMENT OF ALAN REYNOLDS, SENIOR FELLOW AND DIRECTOR, ECONOMIC RESEARCH, THE HUDSON INSTITUTE

Mr. REYNOLDS. Thank you, Mr. Chairman. It seems to me there has been a lot of unnecessary guesswork and speculation about what has been happening to industrial wages, benefits, productivity and employment in Mexico, unnecessary because facts are readily available both from the United States Government and the Mexican Government. Yet people cite such academic journals as Business Week. Actually the graphs in Business Week were accurate but the person who wrote the story did not look at them.

I focus in my testimony on the period from 1987 to 1992. The reason for that is twofold: One, the pacto began in 1988. The question is what affect has it had in controlling wages and compensation.

Two, there were massive devaluations in Mexico from 1982 to 1987, and we know when that happens converting back into dollars becomes extremely suspect.

At the present time, last year specifically, the IMF estimates that purchasing power parity, that is buying power of Mexican incomes, has almost doubled what the figures would suggest. Living costs are simply lower. In a devaluation period, it does not affect the cost of housing so it doesn't tell you very much about what is really going on.

Now what the data shows from 1987 to 1992—I have brought with me an enlargement from a graph in my prepared statement which I would like to have introduced into the record.

Mr. PETERSON. Without objection, it is so ordered.

Mr. REYNOLDS. What this graph shows is the United States data and I will tell you about the Mexican data.

The United States data shows an average growth of wages and benefits in Mexico, and these are in United States dollars, of 18.5 percent a year. Dollar wages have doubled in this period. The Mexican figures show an increase of 32.5 percent per year.

From either of those figures we subtract productivity gains. I use BLS figures through 1990. I don't have them after that, so I use Banco de Mexico. Those productivity gains average 4.9 percent. If you subtract that from compensation, the figures would suggest unit labor costs have been rising at 13.6 percent a year.

If you use the Mexican numbers, they have been rising at 27.6 percent a year. The difference between the two figures is what the BLS calls omitted items of compensation.

BLS cannot keep tract of the perks in every single country. It tries to come up with the basic benefits. In Mexico, they are called prestaciones. They are important and they can count for one-third to one-half of pay. We cannot omit benefits because they are both a cost to the employer and a benefit to the worker.

These prestaciones include mandatory profitsharing of 10 percent of profits paid out as an annual bonus in cash, free or subsidized lunches, transportation, and coupons for such things as groceries; you redeem them at the grocery store for food, like private scrip.

Whether you use the United States or the Mexican numbers, the only sensible question that remains about the effect of the pacto on labor costs in Mexico is have those labor costs merely been soaring, as the United States data suggests, or have they, in fact, been truly exploding?

If we want to take a particular example, there are a lot of particular industry examples in Professor Shaiken's statement. The Ford plant in Hermosillo suffered a 17-day strike recently and the result was an increase in wages of 14 to 16 percent. Inflation in Mexico is 10 percent and falling, so that is a substantial real wage gain, one of many.

Anecdotal impressions about any single plant cannot tell us anything at all about overall competitiveness of an economy in either labor or capital costs. Mexican unit labor costs were about 4 percent lower than the United States in 1990. They were about the same in 1991 on average, not in every plant.

The data suggests that the unit labor costs were higher in Mexico in 1992 and 1993. If so, the United States is now the cheap labor country, which might explain why General Motors moved Cavalier back to the United States, why recent engine plants such as the North Star engines of the Cadillac and the Ford similar engine have been sited in the United States, why Mercedes and BMW picked North Carolina and not Yucatan to site their new plants, et cetera.

It takes almost five Mexican workers to match the output of one U.S. worker, but they are paid more than one-fifth as much, not one-tenth, once you account for the very important perks that they get.

Now if that seems unusual or hard to believe, it is probably the only way we could possibly explain four things that have happened in labor. One, Mexico's trade deficit was $25.9 billion last year. The deficit with the United States alone in manufactured goods alone is variously estimated at $7.5 billion to $15 billion, depending on whether you use United States or Mexican data.

Again, Mexican data are probably better because countries take better care of watching what comes in than what goes out.

Two, Mexico's consumer spending was up 5.9 percent in real terms, inflation-adjusted terms, last year. It is hard to reconcile that with weak income growth.

Three, United States direct investment in Mexico, which was always small and weak, has gotten smaller and weaker, falling to $1.25 billion last year, while Mexico's direct investment in the

United States, buying and building plants in the United States, has increased to almost half a billion dollars last year.

Moreover, the manufacturing sector's share of foreign direct investment has been falling for years. This is pointed out in the GAO report. It was 89 percent of all foreign direct investment, United States and otherwise, in 1984 and fell to 27 percent by 1991. The kind of direct investment that is going on is building shopping malls, an Indiana firm by the way, building fast food restaurants, building hardware stores that sell U.S. goods and building U.S. hotels. This does not take any jobs from the United States, obviously it creates some.

The fourth thing that is only consistent with soaring unit labor costs in Mexico is falling employment in Mexican manufacturing.

If we must cite Business Week, a later issue pointed out that manufacturing employment in Mexico is down 5.6 percent this year. Last year, it fell by 3.9. That is important because when we are talking about productivity there are two ways to get productivity up. One is to raise output and the other is to cut unemployment. We call that "restructuring." Mexico has been faced with enormous restructuring, particularly in textiles and in metals.

There was a 5.9 percent rise in Mexican productivity last year, but only a 1.8 percent increase in manufacturing output. How do we reconcile those two? Manufacturing employment fell by 3.9 percent.

If that is stealing jobs, Mr. Chairman, if they keep stealing them at that rate there won't be any left. In fact, Mexican manufacturing employment has gone nowhere for a decade, except flat or down. Maquiladora employment has risen to about 530,000, but the maquiladoras will be rendered extinct by NAFTA.

Now I do not deny that Mexico can and does assemble quality televisions and automobiles from United States parts. Nobody denies that. Quality is not a measure of productivity and quality in this case is largely because they are consisting of U.S. parts.

What we want to ask in these specific examples in Mr. Shaiken's testimony is what does it have to do with NAFTA, what does NAFTA change? Let's take auto engines. The United States currently imposes no tariff at all on Mexican auto engines. Mexico, on the other hand, imposes a 15 percent tariff on United States auto engines. Mexico enjoys a slight surplus in that trade, quite unique among manufactured goods.

What NAFTA does is level the playing field. Why would any one prefer that we keep Mexico's tariff at 15 percent and ours at zero?

No. 2, NAFTA ends the trade balancing requirements in Mexico that require that a company have a plant there in order to import any cars or parts. That goes away. That is phased out.

Under current law, Mexican law, such a company has to export $1.75 for every dollar it imports back in. That, too, disappears under NAFTA. So companies like Honda Accord, if they can meet the domestic content requirement, Toyota Camry of Kentucky, can export to Mexico for the first time and they won't have to put a plant down there like GM and Ford and Chrysler did because of these onerous Mexican regulations. The regulations disappear.

NAFTA ends the domestic content rules. Mexico requires that to sell a car in Mexico, produced in Mexico, it has to have 36 percent

Mexican parts. That is one reason there has been some parts business growing up down there. That goes away. Ironically, that particular regulation means the famous Ford Escort that we have heard so much about, it cannot be sold to Mexicans under current law. But under NAFTA it can. NAFTA ends all special advantages for maquiladoras. They gradually lose their duty drawback provisions, lose them immediately if they do not sell to Mexicans.

If you hate maquiladoras, you should love NAFTA. NAFTA kills the maquiladoras as we know them.

In conclusion, I would like to say that the whole idea that the United States, the most productive economy the world has ever known, should be afraid of competing on an even basis with tiny little Mexico, of all places, is simply ludicrous. Thank you.

Mr. PETERSON. Thank you, Mr. Reynolds.

[The prepared statement of Mr. Reynolds follows:]

Myths About Mexican Compensation, Productivity and Employment

Alan Reynolds
Director of Economic Research
Hudson Institute
Indianapolis, Indiana

Testimony before the
Employment, Housing, and Aviation Subcommittee
U.S. House of Representatives
August 5, 1993

Myths About Mexican Compensation, Productivity and Employment

Alan Reynolds
Hudson Institute

The Democratic Study Center recently released a paper entitled "Myths About Mexican Workers," by Harley Shaiken of the University of California at San Diego.[1] The main theme of this paper is that certain U.S. and Japanese companies located in Mexico are capable of assembling high quality autos and televisions. This is not news. However, the report correctly points out that "these plants are far from typical," and "there have been some spectacular failures, after which firms have moved their plants back to the U.S."

The author's main source appears to be "field work," described as "kicking the tires of [Mexico's] most advanced plants. Kicking the tires of Mexico's typical plants would yield quite different results. Auto analyst James Womack notes that "hundreds of plants...are far under world scale and have old and unsophisticated equipment...about what the visitor to Ford's Highland Park plant would have seen in the 1920s."[2]

The Shaiken report's subjective impressions are supplemented by purely "hypothetical" cost comparisons, which exclude "the considerable additional cost of [high] technology." For factual information, the report relies heavily on dubious quotes from the popular press, particularly *Business Week* and *The New York Times.*

The report's anecdotal observations about a few successful plants in the auto and television industries -- plants that existed long before anyone dreamed of NAFTA -- have no relevance at all to the effects of NAFTA on either U.S. or Mexican labor markets. Indeed, many of the U.S. auto and parts plants in Mexico would never have been built there if NAFTA had existed in the past. Current Mexican law provides four inducements to locate auto and parts plants inside Mexico that would cease to exist under NAFTA. Mexican laws that virtually forced U.S. auto companies to produce in Mexico rather than export from the U.S. include (1) a trade balancing requirement that companies export $1.75 for every dollar they import; (2) a requirement that cars produced in Mexico have a 36% domestic content before they can be sold to Mexicans; (3) maquiladoras that were granted special exemptions from Mexican tariffs if they exported their output; and (4) formidable import quotas and tariffs that are still 15-20% which made it necessary to leap over those trade barriers in order to sell the rapidly growing young auto market of Mexico. All of these forced investment schemes disappear under NAFTA, making it far more attractive to simply export vehicles and parts to Mexico from the U.S. and Canada.

Shaiken puts considerable emphasis on Mexican production of auto engines and assembly of the Ford Escort and Mercury Tracer in Hermosillo. These examples are actually quite ironic, since NAFTA would surely increase the relatively competitiveness of U.S. products in these industries, while ending current advantages of producing in Mexico. Under current law, exports of Mexican auto engines to the U.S. face a zero tariff, while exports of U.S. engines to Mexico are handicapped by a 15% tariff. NAFTA could not possibly result in increased U.S. imports

of Mexican auto engines, since the U.S. tariff is already at zero! But NAFTA would quite certainly increase exports of U.S. engines to Mexico, since NAFTA would bring Mexico's tariff down to zero too.

Under current Mexican law, it is illegal to sell the Ford Escort and Mercury Tracer to Mexicans, because these cars have a U.S. content of more than 75% (which largely accounts for their high quality), while Mexican law requires a 36% Mexican content. Under NAFTA, such domestic content laws would be illegal, so that this car, which is predominantly composed of U.S. parts, would become available to the rapidly growing Mexican market. NAFTA would also phase-out Mexico's trade-balancing requirement, which (in the absence of NAFTA) will otherwise continue to ban exports of four high-quality U.S.-built cars cited in Shaiken's Figure 2. Because only one Japanese auto company (Nissan) has a plant in Mexico, all others will never be permitted to export to Mexico unless NAFTA passes, including Honda Ohio, Suburu Indiana, Toyota Kentucky and Mitsubishi Illinois (even though some of these models already have a higher U.S. content than some so-called "American" cars).

Shaiken also notes that Sony and Sanyo assemble televisions in Tijuana, as well as in the U.S.. But Japanese companies have been producing televisions in Mexico (and the U.S.) for many years -- a location decision that obviously had nothing to do with NAFTA. The real significance of the relocation of Japanese television companies to Mexico is that very few televisions are now exported from Japan to the U.S. And the Mexican television plants, unlike their Japanese parents, use picture tubes and other key parts manufactured in the U.S. Moreover, many consumers electronics companies have been among the "spectacular failures" in Mexico, such as Admiral, RCA and Philco. Meanwhile, Mitsubishi instead chose to produce its expensive giant televisions in the U.S. (just as BMW and Mercedes recently chose to build new plants in the U.S.).[3]

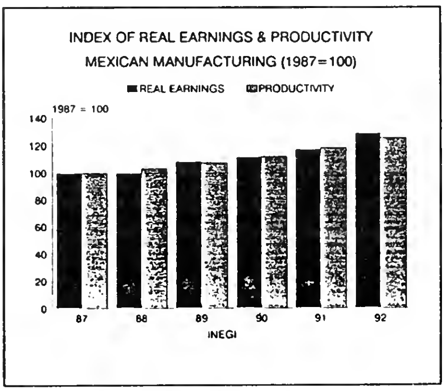
Shaiken somehow considers it an advantage, rather than a high start-up cost, that Mexican auto workers require four months of training before they work, compared with one of two weeks for U.S. workers in Japanese transplants. He quotes a New York Times article to the effect that "the supply of skilled workers [in Mexico] is still greater than the demand for their skills." This is quite untrue. A survey of businesses in Mexico notes that "companies persist in pointing out the great scarcity of labor (31.9%), poorly trained labor (33.6%), and high costs (19.7%) as the main obstacles they face." As Shaiken himself points out "no more than 50 to 60 percent of Mexican children enroll in secondary school, compared with 95 percent here." No serious student of the Mexican economy could possibly deny, as New York journalists can, that the shortage of even semi-skilled labor is a chronic and serious bottleneck in Mexico.

Shaiken asserts that Mexican productivity is "equal or better" than that of the U.S., though only in a few "far from typical" plants. He apparently arrives at this conclusion by confusing product quality with labor productivity: "Though productivity and quality are world class," he claims, "workers remain low paid." Yet the claim of "world class" productivity is unsupported by any evidence, not even for a single plant. The only evidence offered to support this claim deals with the productivity of *machines*, rather than the productivity of labor. The

"machine yield" in Mexican auto engine plants, says Shaiken, nearly matched that of the U.S. after seven years. As he says, though, this is "a measure of the productivity of technology in a capital intensive plant." It provides no information whatsoever about labor productivity, employment or compensation in this or any other Mexican plant, much less for the Mexican economy as a whole.

There are, of course, many other costs other than labor costs, particularly in the sort of capital-intensive plant that Shaiken describes. Even in the relatively labor-intensive textile industry, the U.S. International Trade Commission reports that "the costs of textile mill production in Mexico are 25 to 150 percent higher than in the U.S."[4]

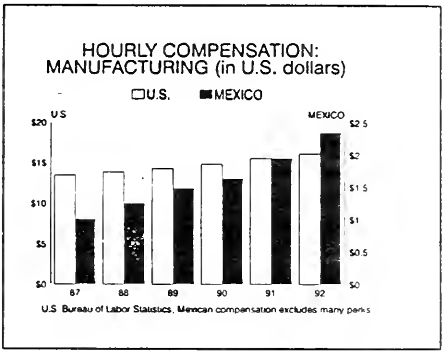
Pat Choate's monograph "Jobs at Risk" found only 5.9 million U.S. jobs in which labor costs exceeded 20% of total costs.[5] The Choate report is fatally flawed, because it fails to show how the industries in which there are supposedly "jobs at risk" (including space vehicles!) would be affected by NAFTA. Yet the fact that he could only come up with 5.9 million reveals what we already know -- namely, that labor costs in most modern industries amount to less than 20% of costs. The Choate list does not include autos or auto parts, for example, since labor-intensive plants cannot possibly compete with robots, regardless of wages. Jobs in the largest U.S industries included in the Choate study -- such as industrial machinery, instruments, fabricated metals and aircraft -- are not "at risk" at all. On the contrary, they are industries with large and growing exports to Mexico, which would enjoy even faster export growth if NAFTA reduced Mexican tariffs of 13-20% on many industrial goods [see Appendix B]. Unlike Mexico, the U.S. imposes trivial or zero tariffs on these products, so NAFTA can only expand exports, not imports. The average Mexican tariff on machinery and equipment is over 11%, for example, while comparable U.S. tariffs range from 0.1% to 2.1%. Printing and publishing supposedly accounts for nearly 1.2 million of the so-called "jobs at risk," for example, though there is no U.S. tariff at all on Mexican printing and publishing, therefore nothing that could possibly be affected by NAFTA.



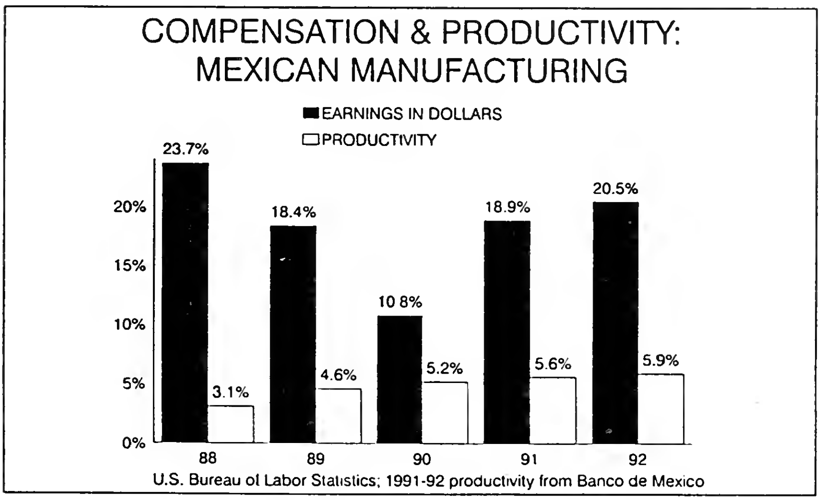
For the labor component, the relevant comparison between the U.S. and Mexico is total unit labor costs (including benefits) expressed in U.S. dollars. Shaiken instead compares only compensation between the U.S. and Mexico (his Figure 4), or he compares Mexico's productivity with "real wages" (his Figure 3). Regarding the latter measure, our first graph shows that real wages have more than kept pace with productivity in recent years. But this reveals almost nothing about relative unit labor costs. Any U.S. manufacturer

considering production in Mexico cares about total compensation costs per unit, in U.S. dollars, not about whether Mexican wages have kept pace with Mexico's consumer prices (i.e., Shaiken's "real wages").

Wages alone, as well as most figures on Mexican compensation, exclude the cost of many of Mexico's notoriously generous benefits ("prestaciones"), including mandatory sharing of 10% of profits plus such things as free lunches, transportation and coupons used to buy food. The U.S. Bureau Labor Statistics measure of compensation is superior to wages alone, but nonetheless explicitly excludes many of these benefits, which would add about an extra dollar per hour.[6] As the second graph shows, however, even the narrow BLS measure of Mexican compensation has been rising much faster that U.S. compensation, when both are measured in dollars. Indeed, the BLS measure of Mexican compensation has doubled in the past five years, in dollars, and Mexican estimates that try to include all perks have increased by 164%.

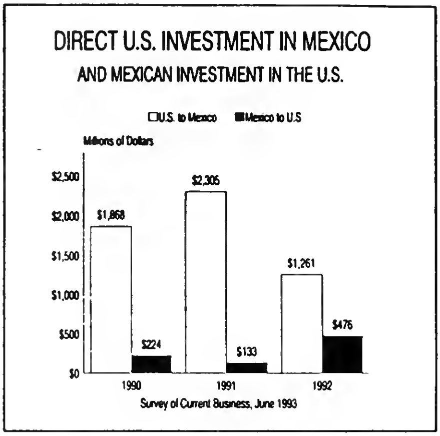


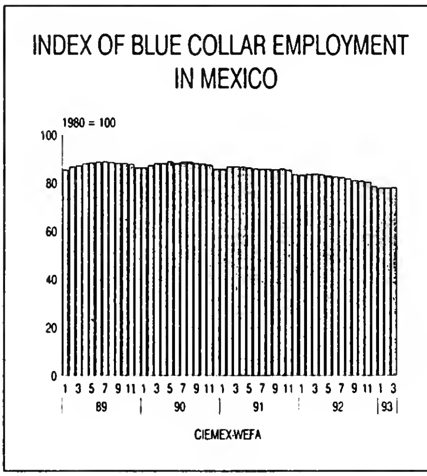
As the BLS measures it, Mexican compensation in manufacturing increased by 18.5% a year from 1987 to 1992, compared with average annual productivity gains of 4.9% (using Banco de Mexico estimates for 1991-92). This suggest that Mexican unit labor costs have been rising



by at least 13.6% a year in dollars, compared with almost no increase at all for unit labor costs in U.S. manufacturing (only 9% from 1982 to 1992).

Unit labor costs have clearly been rising very rapidly in Mexican manufacturing. But the rate of change tells us nothing about the relative *levels* of U.S. and Mexican unit labor costs in any given year. Daniel Oks and Sweder van Wijnbergen of the World Bank made such a comparison for 1991, by using Mexican data on total compensation, including many frequently uncounted benefits. They found that such a broadened measure of compensation costs was 4.7 times higher in the U.S. than in Mexico, while U.S. manufacturing productivity was likewise 4.6 times higher in the U.S.[7] In other words, *unit labor costs in the U.S. and Mexico were virtually identical in 1991.* It took nearly five Mexican workers to match the output of one U.S. worker, so the U.S. workers were paid nearly five times as much. Since 1991, though, with unit labor costs rising in Mexico and falling in the U.S. (thanks to big productivity gains), the U.S. has probably enjoyed a slight labor cost advantage over Mexico.





The relatively high and rapidly increasing unit labor costs in Mexican manufacturing help account for the huge and growing deficit that Mexico has been experiencing in trade in manufactured goods with the United States, which amounted to nearly $15 billion in 1992, according to economist Rogelio Ramirez de la O.

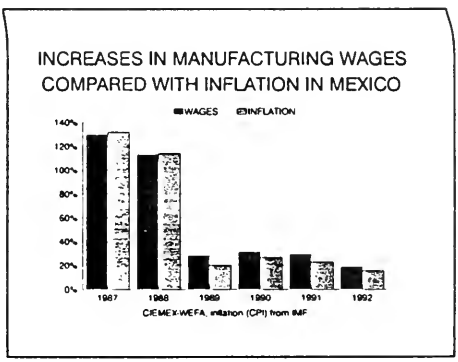
High and rising unit labor costs may also explain why U.S. direct investment in Mexico, which was never significant, fell further in 1992, while Mexican direct investment in the U.S. rose. Moreover, two-thirds of U.S. direct investment in

Mexico has been in business and financial services, shopping centers, hotels, retail stores and restaurants -- investments that enlarge rather than reduce U.S. employment.

High and rising unit labor costs in Mexico also explain the severe decline in manufacturing employment in that country. Trade liberalization has forced painful "restructuring" in Mexican industry, with competition from U.S. goods (and imports of U.S. labor-saving devices) resulting in massive job losses, particularly for blue collar workers in the manufacturing sector. Indeed, much of the rise in Mexican productivity in manufacturing has been due to flat or falling employment rather than rising production. There is more output per worker because there are fewer workers. *In 1992, manufacturing employment in Mexico fell by 3.9%, accounting for most of the 5.9% increase in productivity.*

Mexico employs only 2.4 million people in its manufacturing sector, a figure that has not increased in a decade, and only 531,000 in maquiladoras as of November 1992. If this was "stealing jobs" from Americans, those jobs are quite invisible in Mexico.

Another irrelevant set of statistics in the Shaiken report (his Figures 4 and 5) is the graphing of wage trends going back as far as 1975 or 1979. This is extremely misleading, due to numerous large devaluations of the peso from 1982 to 1987, which makes Mexican pay before that period look artificially high when converted to dollars (the peso was grossly overvalued), and artificially low when the peso collapsed. The exchange rate is a notoriously poor measure of purchasing power, since devaluation mainly affects the costs of traded goods, not such important items in the family budget as housing costs. The IMF has adjusted Mexico's national income (GDP) for purchasing power parity, and finds it to be nearly twice as large as would be implied by expressing peso incomes in terms of dollars.[8] The purchasing power of Mexican wages and benefits is likewise apt to be nearly twice as large as the dollar figures suggest.



Although measuring Mexican wages in dollars makes it look as though they collapsed with every big devaluation up to and including 1987, the last graph, comparing Mexican wages to inflation, shows otherwise. This comparison also shows the actual objective and result of the "Pacto." It would not have been possible for Mexico to bring inflation down from nearly 150% to less than 15% if wage contracts had continued to promise pay increases above 100%. That would have meant that soaring labor costs (in pesos) could not have been recovered in comparable price increases. The "Pacto" committed the government to a slow pace of devaluation, on the condition that unions would agree not strike for 100% annual pay

hikes. It was a matter of de-indexing, so that wages would not keep rising because of last year's price increases. There was never any way enforcing binding controls on either wages or prices under the Pacto, only guidelines, jawboning, and moral suasion.

Shaiken's graphs showing a decline in the dollar value of Mexican wages from 1980 to 1987 (when productivity was also flat or falling) are somehow used to suggest that the Pacto has "snapped the link between rising productivity and improved wages" and put "severe downward pressure on wages in manufacturing." Yet the Pacto came long after this somewhat illusory drop in Mexican wages, and compensation has risen ever since the Pacto began -- both in real terms and in dollars. After the initial success in bringing inflation way down in 1989, there is no evidence whatsoever that the Mexican government has effectively restrained any overall measure of wages or compensation. If jawboning of wages was ever effective in the case of a few large firms, the apparent result has simply been to cause workers to move to other firms or industries that were offering better pay. Shaiken claims the Pacto has "depressed wages in [Mexican] manufacturing," but even his own flawed figures show that this is not true. On the contrary, compensation has risen quite rapidly in Mexico in the past five years, much faster than productivity. And the resulting increase in unit labor costs has contributed to declining employment in Mexican manufacturing, declining net direct investment in Mexico, and soaring imports of U.S. manufactured goods.

Shaiken makes equally curious claims about the U.S. He says "U.S. workers have seen real hourly earnings in manufacturing slip by over 6 percent since 1979." The source of this claim is not listed among the references. However, it obviously excludes benefits, even though typical health and pension benefits have become much more generous since 1979, and are preferred to wages because they are like tax-free income. Although "since 1979" is ambiguous, it appears to compare the cyclical peak of 1979 to the recession of 1990-91. Even if benefits are properly included, it is true that "average" U.S. manufacturing compensation did not increase as rapidly as in the service sector, though such averages may not be representative (e.g, the averages may have been diluted by the influx of new "baby boom" workers, who are always paid less than experienced workers). Contrary to popular nostalgia about blue collar and sweat shop jobs, income growth has been much more rapid in financial, health, business and computer services. And manufacturing accounts for less than 16% of U.S. employment.

Shaiken also cites the Office of Technology Assessment (OTA) report on NAFTA, which is full of unsupportable, even fanciful assertions that real wages and living standards in the U.S. have fallen for decades [see Reynolds 1993]. The particular OTA claim that Shaiken cites is, in his words, that "the proportion of full time workers unable to support a family of four above the poverty line rose from 12 to 18 percent during the 1980s." This is a second-hand reference to a 1992 Census Bureau study which defined "the eighties" as Shaiken does, starting in 1979 rather than 1980. Doing so conceals the inconvenient fact that by far the biggest decline in real wages and incomes, particularly among the poor, occurred in a single year -- 1980. Had this and many other income comparisons been from 1980 to 1990, or even 1979 to 1989, the results would look much different. Despite this deceptive redating of decades, what the Census study actually showed was that *the percentage of low-wage workers living in poor families fell*

quite sharply. Among husbands with such "low-wage" jobs, for example, 35.7% were members of poor families in 1979, but only 21.4% in 1990. It is quite true that more teenagers living in non-poor families, as well as young singles, found more "low wage" jobs in the eighties, when before they were out of work and therefore not counted in wage and income averages. Only 51.4% of single males had full-time jobs in 1974, for example, but 61.8% did by 1989.[9] But it is absurd to judge such entry-level jobs by whether or not they could support a family of four. Very few of us could have supported a family of four on one income at age eighteen or twenty. First jobs rarely pay much, but they are better than none.

Conclusion

Much of the debate over NAFTA has been based on opinion and emotion, with facts being either disregarded or amazingly distorted. There are opinions that Mexican pay has been artificially depressed, while productivity has soared. In reality, this is backwards -- compensation costs have grown much faster than productivity, resulting in average unit labor costs that have soared to U.S. levels and possibly beyond. There are opinions that U.S. direct investment is huge and has resulted in big employment gains in Mexican manufacturing. Again, the facts are precisely the opposite. There are even opinions that Mexico is primarily a "competitor," anxious and able to increase manufactured exports to the U.S., rather than a country with a huge and rapidly expanding appetite for U.S. manufactured goods. Once again, such opinions cannot be reconciled with reality.

The U.S. is by far the most productive, competitive economy in the world. It is baffling how anyone could imagine that we should be frightened about a mutual reduction of trade barriers with an underdeveloped economy like Mexico, particularly since U.S. trade barriers are generally low on important industrial products (see Appendix A), while Mexico's are still relatively high.

It is not possible to look at the facts, as opposed to some U.S. journalist's opinions or even an economist's hypothetical speculations, and still pretend to worry that the U.S. needs to continue to gouge American consumers with inexcusable tariffs on a few trivial industries in order to protect itself against the supposedly formidable competition of little Mexico.

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Additional research on related topics:

Alan Reynolds, *The Political Economy of a North American Free Trade Agreement*, Vancouver, Fraser Institute, 1992.

Alan Reynolds, "The Politics and Economics of the North American Free Trade Agreement," Indianapolis, Hudson Institute, October 1992.

Alan Reynolds, "The Impact of Nafta on U.S. Jobs and Wages" *NAFTA Summit*, D.C., Brookings Institution, Center for Strategic and International Studies, and Fraser Institute, June 28-29, 1993 (to be reprinted in a forthcoming issue of *International Economy*).

Appendix A

Selected Tariffs or Tariff-Equivalent Import Quotas

INDUSTRY	MEXICAN TARIFF	U.S. TARIFF
Lumber and Wood	8.7%	0.5%
Furniture and Fixtures	0.9%	2.2%
Printing and Publishing	0.9%	0.0%
Rubber and Misc. Plastics	9.6%	5.9%
Glass	2.1%	3.0%
Fabricated Metal	8.3%	2.8%
Machinery and Equipment	11.1%	2.7%
Electrical Equipment	11.1%	4.5%
Electronic Components	12.4%	4.1%
Motor Vehicles and Bodies	21.5%	2.5%
Transportation Equipment	13.0%	2.8%
Miscellaneous Manufactures	12.7%	4.4%

Gary C. Hufbauer & Jeffrey J. Schott, *North American Free Trade: Issues and Recommendations*, Institute for International Economics, 1992

Appendix B

Exports to Mexico from U.S. Industries
misidentified as "At Risk" under NAFTA in the Choate Report

MINNESOTA

INDUSTRY "AT RISK"	1987 EXPORTS TO MEXICO	1992 EXPORTS TO MEXICO	PERCENT CHANGE 1987-1992
Textile Mill Products	$57,000	$899,000	1463.9%
Lumber and Wood Products	$7,000	$881,000	11,855.3%
Furniture and Fixtures	$11,000	$1,051,000	9576.9%
Printing and Publishing	$279,000	$1,840,000	560.2%
Rubber and Misc. Plastics	$1,159,000	$8,076,000	597.0%
Stone, Clay, and Glass Products	$101,000	$2,537,000	2411.4%
Primary Metal Products	$958,000	$870,000	-9.3%
Fabricated Metal Products	$1,439,000	$4,257,000	195.7%
Industrial Machinery	$41,154,000	$125,845,000	205.8%
Electric and Electronic Eqpmt.	$6,858,000	$30,444,000	343.9%
Scientific and Measuring Instruments	$2,682,000	$13,525,000	404.3%
Miscellaneous Manufactures	$126,000	$1,657,000	1219.9%

MICHIGAN

INDUSTRY "AT RISK"	1987 EXPORTS TO MEXICO	1992 EXPORTS TO MEXICO	PERCENT CHANGE 1987-1992
Apparel and Related Products	$535,000	$1,368,000	155.9%
Lumber and Wood Products	$124,000	$1,393,000	1024.4%
Furniture and Fixtures	$2,025,000	$32,596,000	1509.4%
Printing and Publishing	$216,000	$809,000	274.0%
Rubber and Misc. Plastics	$8,535,000	$28,602,000	235.1%
Stone, Clay, and Glass Products	$4,919,000	$3,452,000	-29.8%
Primary Metal Products	$17,223,000	$48,768,000	183.2%
Fabricated Metal Products	$16,951,000	$32,662,000	92.7%
Inductrial Machinery	$129,511,000	$226,476,000	74.9%
Electric and Electronic Eqpmt.	$20,313,000	$94,095,000	363.2%
Scientific and Measuring Instruments	$7,872,000	$14,199,000	80.4%
Miscellaneous Manufacturing	$253,000	$9,750,000	3751.3%

U.S. Dept. of Commerce, U.S. Exports to Mexico: A State by State Overview

Notes

1. Harley Shaiken, "Myths About Mexico" Democratic Study Center Report Series, June 29, 1993.

2. James P. Womack, "A Positive Sum Solution" in M. Delal Baer & Guy F. Erb, eds., *Strategic Sectors in Mexican-U.S. Trade*, D.C., Center for Strategic and International Studies, 1991, pp. 45-46. See also Steven Berry, Vittorio Grilli & Florencio Lopez-de-Silanes, "The Automobile Industry and the Mexico-US Free Trade Agreement," *Working Paper* No. 4152, Cambridge, National Bureau of Economic Research, August 1992.

3. National Institute for Statistics, Geography and Information, *Mexico: Economic and Social Information*, Jan-Apr 1992, p. 23.

4. U.S. International Trade Commission, *The Likely Impact of a Free Trade Agreement With Mexico*, February 1991, p. 4-39.

5. Pat Choate, *Jobs at Risk: Vulnerable U.S. Industries Under NAFTA*, D.C., The Manufacturing Policy Project, April 1993.

6. Mexico's Institute of Statistics, Geography and Information (INEGI), estimates average overall 1992 remuneration in the industrial sector at 91,407.6 pesos per day, which would be $3.69 an hour on a typical 8-hour day (this appears to exclude a half million *maquiladora* workers, mostly young and unskilled). The comparable BLS estimate for 1992 is $2.65, which apparently includes *maquiladoras*, and does not claim to include all benefits. Since the INEGI's figure for 1987 was $1.40 an hour, this shows a 163.5% increase in broadly-measured Mexican labor costs from 1987 to 1992, or 32.7% a year -- nearly double the BLS increase of 18.5% a year. To be conservative, our graphs use BLS data, albeit with reservations.

7. Daniel Oks & Sweder van Wijnbergen, "Mexico After the Debt Crisis: Is Growth Sustainable?" D.C., World Bank working paper, October 1992, pp. 23-24.

8. *The Economist*, May 15, 1993, p. 83. On a purchasing power parity basis, Mexico's GDP per person was $6,590 in 1992, compared with an unadjusted figure of $3,700.

9. Alan Reynolds, "Upstarts and Downstarts," *National Review*, August 31, 1992.

Two Day

NAFTA SUMMIT

Beyond Party Politics

June 28 and 29, 1993

Day 1: June 28, 1993
House of Representatives
Caucus Room, Third Floor
Cannon House Office Building
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Day 2: June 29, 1993
Senate
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Robert Matsui (D-CA)
Bill Richardson (D-NM)

Senate

Max Baucus (D-MT)
Bill Bradley (D-NJ)
Conrad Burns (R-MT)
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M. Delal Baer, Center for Strategic and International Studies (CSIS)
Nora Lustig, The Brookings Institution

Support was provided by the Fraser Institute

THE IMPACT OF NAFTA ON U.S. JOBS AND WAGES[1]

By Alan Reynolds

Nafta is about reducing trade barriers. Opponents of Nafta are in favor of retaining trade barriers, which means letting a few politically-favored interest groups continue gouging consumers. Since nobody wants to put it quite that way, they resort to all sorts of nonsensical arguments that can be easily dismissed by asking one simple question: "What does this have to do with Nafta?"

The two most polemically effective scare stories about Nafta - plant relocations and falling wages - have been most colorfully expressed by Ross Perot. First, Perot claims Nafta would cause a huge "sucking sound," as U.S. businesses rushed to move plants to Mexico, causing, he says, as many as 5.9 million jobs to be lost. Second, Perot argued that wages may rise to $7 an hour in Mexico, as a result of Nafta, but also fall to $7 an hour in the U.S.

What does this have to do with Nafta? Why should Nafta make it any more attractive than it is now for U.S. companies to locate in Mexico? Things that Nafta does not change - such as the cost of U.S. regulations or the cost of Mexican labor - will not be changed by Nafta. Pointing to such things makes no more sense than suggesting that if Nafta is enacted, people in the snowbelt will move to Mexico to avoid the snow.

The notion that firms will move to Mexico in search of "cheap labor" is an obvious *non sequitur*. Nafta will not make Mexican labor any cheaper. On the contrary, anticipation of Nafta has already helped to double average compensation of Mexican manufacturing workers - in dollars - in only the past five years.

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[1] Director of Economic Research at the Hudson Institute in Indianapolis. The author is indebted to the Fraser Institute North America 20/20 Project for research support.

As the U.S. Bureau of Labor Statistics measures it, hourly manufacturing compensation averaged $16.17 in the U.S. in 1992 - 6.9 times the Mexican compensation of $2.35.[2] However, "omitted items of compensation" in Mexico include compulsory sharing of 10% of profits with workers, and many other private perks ("prestaciones") which range from free lunches and transportation to coupons that can be redeemed for groceries. These benefits typically add up to at least a third of compensation, sometimes half.

Moreover, looking at Mexican pay in U.S. dollars gives a misleading picture of purchasing power. The IMF recently estimated that the purchasing power parity of Mexico's *per capita* GDP is almost twice as large as the dollar figure suggests.[3] This means total compensation of $2.35 an hour, plus uncounted perks, is comparable to a U.S. wage of roughly $5 an hour in terms of buying power.

By using the more accurate Mexican statistics on actual compensation in that country, two World Bank economists calculate that U.S. manufacturing compensation was actually only 4.7 times higher than in Mexico in 1991. Since U.S. manufacturing productivity was 4.6 times higher than in Mexico, that means productivity-adjusted compensation costs in 1991 were

[2]U.S. Bureau of Labor Statistics, "International Comparison of Manufacturing Hourly Compensation Costs: 1992," U.S. Department of Labor News, March 18, 1993. In a letter to Roll Call, May 17, 1993, Pat Choate says Mexican factory workers "are paid approximately $1.15 an hour." There is no way such a number could possibly be defended. It is like saying the average factory worker's wage in the U.S. is "approximately" the same as entry-level wages in the Mississippi Delta. Even more remarkable is Richard Rothstein's claim, in The American Prospect, Winter 1993, that "experience plainly suggests that while Mexican productivity may grow, wages and purchasing power may not rise." In reality, Mexican wages and benefits have been increasing much faster than productivity for five years.

[3]On a purchasing power parity basis, Mexico's GDP per person was $6590 in 1992, compared with an unadjusted figure of $3700. Since half of Mexico's population is below age 16, and therefore not in the labor force, real GDP per worker is relatively high. The Economist, May 15, 1993, p. 83.

virtually identical in the U.S. and Mexico.[4] It takes almost five Mexican workers to produce as much as one U.S. worker, and therefore each Mexican worker was paid one-fifth as much. It is unit labor costs, not wages *per se*, that determine the profitability of hiring workers in the two countries. If wages were all that mattered, regardless of the quality of human capital, then all the best factories in the world would have relocated to Somalia, Bangladesh and Haiti many decades ago. Mexican wages, like other low prices, have been low for a reason - Mexican productivity is low. Only one fifth of Mexico's population, for example, has finished high school.[5] Productivity has recently been rising in Mexico, but compensation has risen much faster, because skilled labor is quite scarce.

According to a survey by the Mexican Finance Ministry, "companies persist in pointing out the great scarcity of labor (31.9%), poorly trained labor (33.6%), and high costs (19.7%) as the main obstacles they face."[6]

Since 1987, Mexico's manufacturing compensation has risen by 18.5% a year, in dollars. Mexican productivity gains from 1987 to 1990 were less than 4%, according to the BLS,[7] but apparently higher in 1991 and 1992 (partly due to a large drop in Mexico's manufacturing employment). Even if Mexican productivity had been rising at a 6% rate, as Business Week recently claimed, the increases in compensation have been three times as large as productivity

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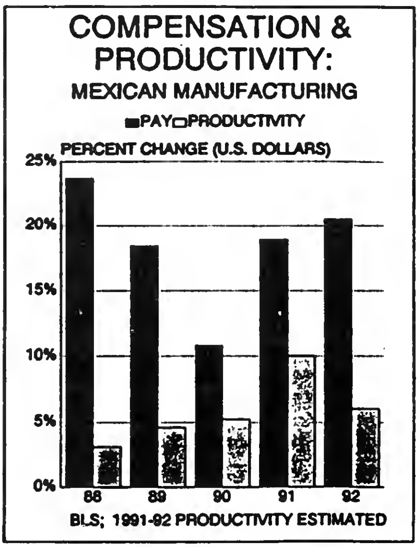
[4]Daniel Oks and Sweder van Wijnbergen, "Mexico After the Debt Crisis: Is Growth Sustainable?" World Bank draft, October 1992, pp. 23-24.

[5]National Institute for Statistics, Geography and Information, Mexico: Economic and Social Information, Jan-Apr 1992, p. 10.

[6]Ibid., p. 23.

[7]BLS, Office of Productivity and Technology, August 1992. Mexican productivity gains in manufacturing over the entire 1981 to 1986 period were virtually zero.

gains. That means an annual increase in unit labor costs of at least 12%. In the U.S., by contrast, manufacturing unit labor costs rose only 9% over the entire decade ending in 1992, thanks to a 32% increase in U.S. productivity, and have been flat or falling since 1991.[8] Although industrial labor costs were about equally cheap in the U.S. and Mexico in 1991, average unit labor costs in manufacturing apparently became more costly in Mexico than in the United States in 1992-93.



[8]U.S. Bureau of Labor Statistics, Monthly Labor Review, March 1993, pp. 97 & 103.

In short, labor in Mexico is not cheap, once total compensation costs are properly compared with productivity. But cheap labor was never the main reason for setting up manufacturing operations there. Instead, the main reason U.S. plants were built in Mexico was to get around Mexican trade barriers that would soon disappear under Nafta.

The Big Three automakers and many U.S. computer companies built plants in Mexico many years ago in order to sell to Mexicans without the handicap of Mexico's formidable import quotas and tariffs. Indeed, much of the direct investment in Mexico in recent years has been forced investment, which would be illegal under Nafta. Auto companies, for example, have to export $1.75 in cars or parts from Mexico before they are allowed to import a dollar's worth of cars or parts into Mexico. And they have to buy 36% of their parts from Mexican suppliers. Under Nafta, the "tradebalancing" requirements are phased out, because the Big Three fear their Mexican plants could not withstand competition from U.S. and Canadian manufacturers such as Honda, Toyota and Subaru/Isuzu. Mexico's domestic content law disappears under Nafta, replaced by rules which treat U.S. or Canadian auto parts no differently than Mexican parts

Since high Mexican tariffs, trade balancing requirements and domestic content laws virtually compelled U.S. companies to build plants in Mexico if they wanted to sell there, why should eliminating such trade barriers--through Nafta--have the same effect? It clearly will not. Instead, more U.S. manufacturers will stay home and export to Mexico from the U.S. and Canada.

Ross Perot's absurd "estimate" that up to 5.9 million U.S. jobs would relocate to Mexico is based on adding up every U.S. job that pays over $6 an hour in every industry in which labor

is more than 20% of costs.[9] Perot got the figure from Pat Choate, who, in turn based the estimate on a promotion by the "Amerimex Maquiladora Fund" which is trying to get people to build maquiladoras in the depressed area of Yucatan. The Fund claimed it might make sense for U.S. industries in which wages were $7-10, and more than 20% of costs, to consider relocating to Yucatan. Though Choate claims to us this "Amerimex criteria" that is not true. Choate actually went much further, counting all industries with wages of $6 to $19 an hour, in order to pad the 5.9 million figure. The results can most charitably be described as silly. Among the "low to mid-tech operations" in the Choate report, even "guided missiles and space vehicles" are supposedly at risk of moving to Yucatan! Other "jobs at risk" include Mexico doing what Japan and Europe have been unable to do - namely, beat the U.S. at making aircraft and computers.

What does the Choate report have to do with Nafta? Absolutely nothing. Yucatan has ben trying to lure maquiladoras since 1984 - attracting fewer than 2 percent of Mexico's maquilas so far.[10] Maquiladoras, whether in Yucatan or elsewhere, would stand a much better chance of surviving without Nafta than they will with it. Neither Choate, Perot or anyone else has explained how Nafta could possibly make Mexican labor any cheaper, or make maquiladoras more profitable. In fact, Nafta makes Mexican labor more expensive, and makes maquiladoras obsolete.

The largest of the so-called "vulnerable industries" in which the Choate report claims U.S. jobs are "at risk" under Nafta happen to be precisely those products the U.S. is exporting to Mexico, and in which U.S. exports will grow even faster once Mexican trade barriers come down

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[9]Hobart Rowen, "NAFTA-Bashers Obscure The Truths of a Treaty" Washington Post, May 9, 1993.

[10]"If you can't, Yucatan can" The Economist, May 22, 1993, pp. 49-50.

to U.S. levels - industries such as industrial machinery, instruments, fabricated metal products, aircraft and parts.[11] These jobs cannot possibly be "at risk" from lower U.S. tariffs or quotas, because there are few, if any, U.S. tariffs or quotas. The average Mexican tariff on machinery and equipment is over 11%, and would be higher were it not for "trade weighting" the average (since there is little trade in highly protected goods), while U.S. tariffs now range from 0.1% to 2.1%.[12]

What the Choate report does show, however, is the surprisingly tiny fraction of U.S. employment in industries in which labor still accounts for more than 20% of costs - fewer than 6 million out of 118 million U.S. jobs. Autos and parts, for example, do not make the list. Even if labor were generally cheaper in Mexico, which it is not, asserting that location decisions are based on 20% of costs rather than on 80% of costs is a tail-wags-the-dog argument. Building new plants and filling them with modern machinery is not cheap, and rents are often higher in Mexico City than in comparable U.S. cities. It is because non-labor costs matter that the first International Trade Commission report on Nafta estimated that even then, before Mexican labor costs had risen much, "the costs of textile mill production in Mexico are 25 to 150 percent higher than in the U.S."[13] In short, labor costs are (1) not nearly as important as Mr. Perot supposes; (2) higher in Mexico than in the U.S. once perks and productivity are considered; and (3)a red herring, since Nafta will raise, not lower, Mexican pay. Besides, Mexico, with a youthful labor

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[11]Jobs at Risk: Vulnerable U.S. Industries and Jobs Under NAFTA, D.C., The Manufacturing Policy Project, April 1993, pp. 6-7.

[12]G. Hufbauer and J. Schott, North American Free Trade Agreement, D.C., Institute for International Economics, 1992, Table 3.6.

[13]U.S. International Trade Commission, The Likely Impact of a Free Trade Agreement with Mexico, February 1991, p. 4-39.

force of 24 million and low unemployment in urban areas, does not have 5.9 million qualified workers to spare.

The National Bureau of Economic Research recently released a study on Nafta's impact on the auto industry.[14] It concludes that "the primary effect of a free trade agreement will be the opening of the (potentially large) Mexican market to North American producers." The study also concludes that much of Mexico's auto and parts industry "is likely to be replaced by other North American producers." It should be easy to see why. The U.S. already imposes no tariff at all on auto engines exported from Mexico, and only a 2.5% tariff on cars. But Mexico levies 15-20% tariffs on U.S. engines and cars exported to Mexico, plus strict trade-balancing quotas and Mexican-content rules for Big Three cars assembled in Mexico. Mexicans are not even allowed to buy the Mercury Tracer, made in Hermosillo, because it has too many U.S. parts (80%) to meet Mexican content rules (which disappear with Nafta).

The second reason why some U.S. firms built plants in Mexico was the "maquiladora" program. These plants specialize in assembling the few products that both the U.S. and Mexico would otherwise protect, such as apparel, certain auto parts and televisions. Spokesmen for organized labor pretend that Nafta will turn Mexico into a "giant maquiladora." In fact, Nafta kills the maquiladoras. Any company anywhere in Mexico will eventually have the same duty-free access to U.S. materials that maquiladoras have. And such companies will no longer be required to export the resulting products back to the U.S., but can instead sell them in Mexico, Chile, Venezuela, Colombia, or anywhere else. If you hate maquiladoras, you should love Nafta.

Portfolio, Not Direct, Investment

[14] Steven Berry, Vittorio Grilli, Florencio Lopez-de-Silanes, "The Automobile Industry and the Mexico-U.S. Free Trade Agreement," NBER Working Paper No. 4152, August 1992, pp. 3-4.

Investment opportunities have indeed improved in Mexico, but these investments are mainly in the stock of privatized Mexican companies and banks, plus foreign purchases of Mexican Treasury bills (cetes). New opportunities for U.S. investors to supply capital to the Mexican telephone system, for example, benefitted Mexico and its U.S. investors, but better telephone service in Mexico does not hurt U.S. employment opportunities.

Direct U.S. investment in Mexico, which includes buying existing structures and equipment, as well as adding new capital, amounted to only $2.3 billion in 1991 (and even less in 1992). And $1.6 billion of that consisted of reinvested earnings of U.S. companies already located in Mexico - which usually means importing machines from the U.S.[15] Total U.S. direct investment in Mexico only amounts to 2.6% of worldwide U.S. direct investment, most of which is in Western Europe.[16] Yet nobody argues that, say, building Fords in Europe loses U.S. jobs.

Putting reinvestment aside, Americans made only about $700 million of new direct investments in Mexico in 1991. And a sizable portion of that new investment went into building U.S. fast food franchises, hotels, and retail stores investments that in no way jeopardize U.S. jobs (hotels and restaurants in Mexico City do not compete with hotels and restaurants in Indianapolis), and instead make it easier to sell more U.S. goods and services to Mexicans.

How can such tiny figures be reconciled with all the anecdotal stories about companies setting up maquiladora border plants to export to the U.S.? When we consider that the total value added of all maquiladoras is only a bit more than $4 billion a year, the answer is easy. They don't amount to much of anything by U.S. standards - barely producing enough to pay for

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[15]U.S. Department of Commerce, Survey of Current Business, August 1992.

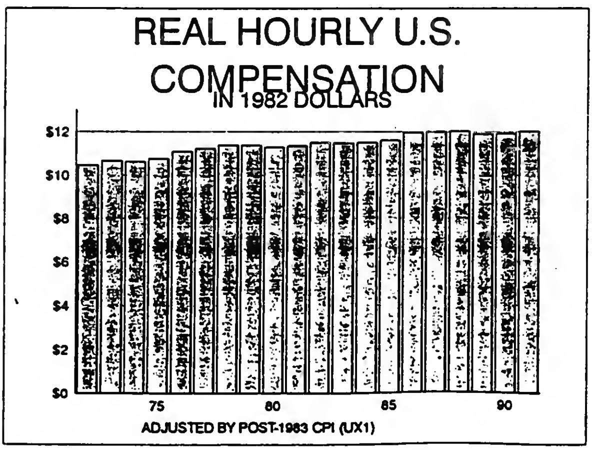
[16]General Accounting Office, North American Free Trade Agreement: U.S.-Mexican Trade and Investment Data, September 1992, p. 70.

10% of Mexican imports from the U.S.

Even if new, direct U.S. investments in Mexico quadrupled to three billion a year, that would still be trivial compared with private and public investment in the U.S. of close to a trillion dollars each year. Foreign direct investment in the U.S. was over $69 billion in 1989 alone. When BMW and Mercedes looked for a place to build new factories, Mexico didn't stand a chance against South Carolina (except that Mercedes is going to assemble 300 kit cars in Mexico for the local market).

Have U.S. Wages Really Fallen?

Much of the anxiety about trade reflects serious misconceptions about what has been happening to U.S. wages and incomes. The first page of a remarkably ill-informed "study" on Nafta by the Office of Technology Assessment (or "OTA"), for example, asserts that, "Stagnant productivity and increasing international competition have brought real wages...back to the level of 1965....[17]



[17]Office of Technology Assessment, U.S.-Mexico Trade: Pulling Together or Falling Apart? 1992.

The claim that real U.S. wages are no higher than they were in 1965 is almost as incredible as the insinuation that international competition has lowered real wages - which implies that competition is bad for productivity. Measured in 1982 dollars, hourly U.S. compensation averaged $8.35 in 1965 and $12 in 1992 - a 44% increase.[18] The contrary impression is largely caused by deflating weekly wages by the discredited pre-1983 consumer price index (which exaggerates accumulated inflation and thus lowers real wages), excluding all benefits, and using weekly or annual rather than hourly wages, which dilutes the average with part-time and summer jobs. Another common trick is to compare current real wages with those of 1973, when price controls grossly understated inflation, and thus overstated real wages.

In short, a lot of bogus wage and income figures are being circulated as a feeble excuse for inexcusable protectionism.

Ed Leamer of UCLA argues that increased flows of labor-intensive products from the Third World must depress prices of such goods and therefore depress the relative wages of those U.S. workers who remain employed in these industries.[19] This is the source of Ross Perot's claim that higher wages in Mexico must bring lower wages in the U.S. Yet the idea that prices determine wages is almost as faulty as the idea that lower prices reduce real wages. Computer prices have fallen, for example, without that industry paying Third World wages. And in the few cases where tariffs and quotas keep U.S. prices artificially high - such as sewing T-shirts or picking tomatoes - wages have always been notoriously low. Firms in protected industries do

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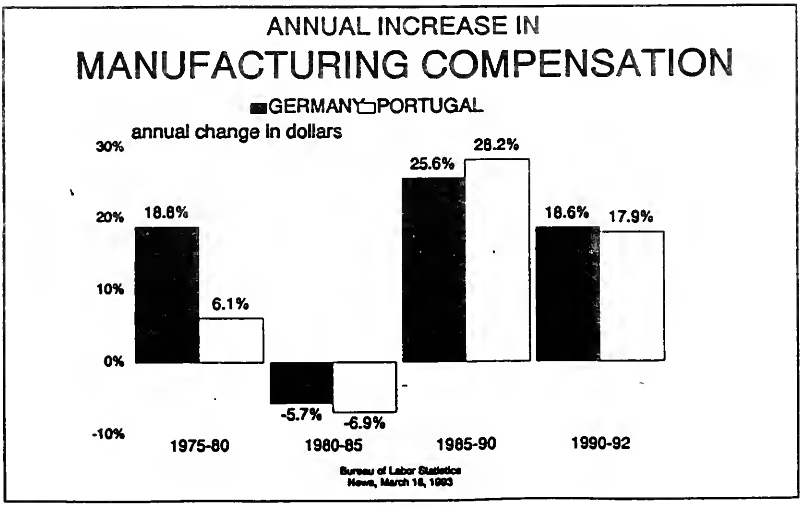
[18] Economic Report of the President, January 1993, Table B42, p. 396.

[19] Edward E. Leamer, "Trade Policy and Income Distribution" in Gerald P. O'Driscoll, ed., Free Trade Within North America, Kluwer, 1992; and "Wage Effects of a U.S.-Mexican Free Trade Agreement" NBER Working Paper No. 3991, February 1992.

not have to pay more than the going rate to attract unskilled labor. Instead, the going wage is established in thousands of unprotected industries - allowing protected industries to extract monopoly rents.

The only evidence Leamer cites are suspiciously vague and ancient trade and income figures for 1985, before U.S. exports doubled in real terms. He also asserts that letting poor countries like Portugal into the EC lowered real wages in rich countries like Germany. This is obviously false:



Freer trade between the U.S. and Mexico might lower the relative price of a few protected, labor-intensive goods in the U.S., such as brooms, hats, and rubber shoes - if the U.S. is still producing such primitive products when Mexico becomes big enough to have much effect on U.S. prices. But freer trade will likewise lower the relative price of capital-intensive goods in Mexico - increasing the capital intensity of Mexican production, raising productivity and wages there, while also increasing Mexican demand for capital-intensive U.S. exports, such as machines, where U.S. productivity and wages are high. It is not that "capital" benefits from freer trade at the expense of "labor," as Professor Leamer's two-factor theory assumes, but rather that there will be more capital-intensive job opportunities with freer trade - jobs in which an hour of work produces something of great value.

Reduced U.S. trade barriers also mean a lower cost of production and lower cost of living. This obviously raises the real buying power of wages. Yet even this obvious benefit of freer trade is somehow excluded from all these fables about why real wages are supposed to fall, particularly for the poor. U.S. protection is most brutal in raising the price of fruit, vegetables, milk, tuna, peanuts, sugar, shoes and clothing - hardly the most effective way to help the poor.[20]

The only U.S. jobs that could possibly be adversely affected by Nafta are in labor-intensive industries that are currently protected by high tariffs or import quotas. But half of Mexico's exports are completely duty-free under the GSP program. Nearly another half are subject to only trivial duties because of the maquiladora program, and because the vast majority of U.S. products - particularly those on Pat Choate's list - are not protected anyway, or have by tariffs no higher than 2.5%.

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[20]Cletus C. Coughlin, et al., "Protectionist Trade Policies: A Survey of Theory, Evidence and Rationale," Federal Reserve Bank of St. Louis, Review, Jan/Feb 1988.

With one exception - textiles and apparel - the highly protected U.S. industries are extremely small. And Mexico has been shutting down many textile and apparel plants, becoming the number one export market for U.S. textiles and apparel (the U.S. has a large and growing surplus, particularly in textiles). There is a 28% U.S. tariff on frozen orange juice, a 32% tariff on brooms, 35% on canned tuna, 38% on cheap glassware, and a 45-65% tariff on athletic shoes. A review of Congressional testimony reveals that these industries (along with the infamous cartels of sugar, peanut and tobacco farmers) have been the most vocal opponents of Nafta. Yet all of them together employ fewer than 50,000 people, usually at very low wages. Even in these tiny industries, wages are quite unlikely to fall, because growth of export and service jobs will make that impossible. Industries that do not keep their wages and benefits competitive simply cannot attract and retain the workers they need. Indeed, it is the fact that inefficient, protected U.S. industries cannot pay competitive wages that ultimately dooms them, with or without Nafta. Trying to force consumers to pay higher prices for their products through trade barriers, simply shrinks demand and thus reduces employment through a different route. For example, U.S. consumers simply substitute corn sweeteners for protected sugar, corn nuts for protected peanuts, or plastic glasses for protected glassware.

Compared with about 50,000 low-wage jobs that might be adversely affected by lower U.S. tariffs (or even triple that number by some dubious estimates), there are at least seven million high wages jobs in U.S. export industries that stand to benefit enormously from increased access to the growing, young market of Mexico. And that is not even counting wholesale and retail trade, port services, grain and dairy products, banking and business services or air travel. Even a small percentage change in the huge U.S. export industries must create many more high-

wage jobs than any low-wage jobs that could possible be at risk from reducing U.S. tariffs on a few tiny industries which will shrink or become automated anyway, because consumers do not value their products highly enough to justify a competitive wage.

The net job gains from expanding the huge U.S. export industries with the help of Nafta must far exceed possible job relocation problems out of the few, tiny protected industries. The resulting tighter U.S. job market must reduce, not increase, the need for job retraining. And more and better jobs in exports industries, combined with the demographic slowdown in the supply of new workers, can make even unskilled U.S. workers more scarce, thus pulling all wages up toward the level of pay in the expanded export industries.

On the export side, numerous huge, high-paying industries stand to gain from reduction of Mexico's relatively steep trade barriers. The U.S. is already running large and growing surpluses with Mexico in industrial and farm machines, textiles, chemicals, paper, food products, fabricated metal products, instruments, auto parts, aircraft, machine tools, steel, and more. These industries employ at least seven million people at wages two to three times higher than those of the tiny, protected industries.[21] Last year, the U.S. ran a trade surplus with Mexico of about $15 billion in manufactured goods, far exceeding a deficit in crude oil, fruits and vegetables.

The whole idea that lower trade barriers could possibly reduce real wages is quite bizarre. Since real income per worker ultimately depends on real output per worker - productivity - then any claim that freer trade lowers wages amounts to claiming that protectionism increases real wages by increasing productivity! If tariffs and quotas really made economies more efficient and productive, we'd have to throw out every economics text since Adam Smith. Since the precise

[21] Alan Reynolds, "The Political Economy of a North American Free Trade Agreement," Studies on the Economic Future of North America, Vancouver, B.C., Fraser Institute 1992, Table 4, p. 54 and Table 7, p. 93.

opposite is true, living costs will fall, and productivity and real U.S. wages will surely increase on both sides of the border as a result of the bold and invigorating mutual reduction of destructive trade barriers called "Nafta."

Mr. PETERSON. I have this saying, I am a CPA and I used to tell my clients that figures lie and liars figure. We have had too many figures today and my mind is boggled by all these numbers.

But just in looking at this overall situation here, it is still hard for me to figure out why we ought not to be concerned about some of these specific industries where clearly—I think I am persuaded by Mr. Shaiken's arguments that there is a significant advantage in certain of these industries if they have the machines and the technology equivalent to the United States, so that labor cost differences is going to make a difference and it is a big difference.

I am persuaded from what I have been able to look at that in certain of these industries they have almost caught up to us in productivity. Yet, you in your testimony basically say that you don't believe that. I guess it is hard for me to——

Mr. REYNOLDS. There is no evidence that it is true on an average or macro level.

Mr. PETERSON. We are not talking about averages.

Mr. REYNOLDS. If I said Nucor Indiana is the most competitive steel mill in the world, does that mean our entire steel industry is competitive? No, of course not.

Mr. PETERSON. But there are specific industries and there are specific situations in Mexico where they are coming very close to us in productivity.

Mr. REYNOLDS. Possibly true.

Mr. PETERSON. With this tremendous wage difference, they are going to have a competitive advantage, are they not, in all those specific circumstances?

Mr. REYNOLDS. The question is, is there a difference in unit labor costs and, on average, the answer is no. Let me deal with some of the specific companies we are talking about here. The Ford Escort is 75 to 80 percent U.S. content. It is officially a U.S. car under CAFE standards. And it is going to stay that way because that is the way Ford likes it. It lowers their fuel economy standards. They are not going to increase that part about it.

Chrysler is going to build a competitor for that car. It is going to be called the Neon with 300,000 capacity. It is going to be sited in Michigan. Why didn't Chrysler site it in Mexico? One reason is unit labor costs. One would assume they are looking at that the same way anyone else is.

Only one Japanese auto company is located in Mexico, why?

Mr. PETERSON. Basically there is no market for cars in Mexico.

Mr. REYNOLDS. The market in Mexico is growing 25 to 30 percent a year. They don't have the capacity to meet domestic demand and——

Mr. PETERSON. I was told that there was a market for 600,000 cars in Mexico. Now I am told by my staff it is 445,000 cars.

Mr. REYNOLDS. But it is growing very rapidly and trucks as well.

Mr. PETERSON. That is a drop in the bucket compared to the amount of cars that are sold in the United States or are exported or even produced in Mexico. They produce way more cars than 445,000 in Mexico now, isn't that true?

Mr. REYNOLDS. They will have the capacity in the next few years to probably produce 700,000 cars. How they can export, with the domestic demand growing as rapidly as it is, that will require huge

additions to capacity, as Mr. Shaiken will tell you. He thinks it is going to happen, but there is no evidence from data or anybody's plans that it is going to happen.

Mr. SHAIKEN. I think Mr. Reynolds is very, very factually wrong on these issues. I would like to specifically anchor the discussion in the Ford Hermosillo plant.

First of all, the plant went online in 1986, as I mentioned, with a $500 million investment. Ford committed to produce 30 percent of the parts for the car in Mexico in order to sell 20 percent of its total output in Mexico.

The demand was so dismal for the auto industry from 1986 to 1990 that Ford met its obligation of 30 percent local content but chose not to sell any vehicles in Mexico, though it was legally entitled to do so based on its agreement with the Mexican Government.

In 1990, it then switched to a new model, adding a new Ford Escort and Mercury Tracer model. But because it wanted to qualify the car under U.S. CAFE standards, the corporate average fuel economy, it shut down most of its Mexican supplier base and moved that to the United States so it could identify the car as a U.S.-made vehicle for CAFE.

Under NAFTA, that stipulation disappears. Ford will no longer have to do that. Therefore, it can begin moving large parts of that supplier base back to Mexico.

In talking with various people close to the situation, they rank the 30 percent of the value of the car built in Mexico as superior to United States suppliers, inferior to Japanese suppliers, but improving rapidly.

Now, how Mr. Reynolds can talk about average unit costs when the real issue is looking at how you site a specific plant, and we have discussed in specific detail what the unit cost is of producing a Tracer or an Escort in terms of direct labor costs in Mexico. There is an indisputable, sizable advantage because the productivity of that plant matches the productivity of the U.S. plant at one-tenth the total compensation.

It is that simple. This is a legitimate issue of how far can you replicate this. Is this an isolated example or can you generalize? What we have seen is wide generalization in the auto and electronic sectors during the 1980's which is likely to accelerate during the 1990's.

I would point out this is not an issue of being for or against NAFTA; this is an issue of understanding the dynamic which influences investment. It is not a question of the United States competing with the Mexican economy. It is a question of an auto parts supplier in Michigan, Indiana, or anywhere else saying, OK, I am paying $12 an hour now. I can get the same productivity for $2 an hour. What do I do?

Then we have to ask why is it $2 an hour in Mexico. Economists say it is because of the productivity. But we have seen that is not the case. It is $2 an hour precisely because the wages are not related to productivity.

Mr. PETERSON. There is pressure because there are so many people who want jobs, so it keeps the wages down.

Mr. SHAIKEN. Enormous pressure to keep the wages down. From that alone, let alone the government policies and let alone the lack of labor rights.

In terms of Mr. Reynolds' statement about Chrysler in particular, he obviously has not seen the July 12, 1993, issue of Automotive News. The headline reads "Chrysler-Mexico in talks for new vehicle plant. Chrysler Corporation is looking at a site in northern Mexico for a new assembly plant."

The last paragraph of the article summarizes the issue: "U.S. automakers are sensitive to news about capacity increases in Mexico, in part because of the controversy surrounding the proposed North American Free Trade Agreement."

Mr. PETERSON. Can we get a copy of that?

Mr. SHAIKEN. Yes.

[The information follows:]

Chrysler, Mexico in talks for new vehicle plant

JOHANNES WERNER
Staff Correspondent

MEXICO CITY — Chrysler Corp. is looking at a site in northern Mexico for a new assembly plant.

"There are plans, and there are negotiations between our government and Chrysler," said Cesar Gonzalez, an aide in the state of Coahuila's office for planning and development.

The negotiations center on the purchase of a tract just south of Saltillo, about 40 miles southwest of Monterrey. A local newspaper reported the land was recently bought by Chrysler.

The company already manufactures four-cylinder engines, mostly for export to the United States, in a plant north of Saltillo.

"Chrysler intends to assemble pickups" in the new plant, said Jesus Oranday Cardenas, director of Coahuila's Office for Industrial Promotion. That plan would make sense because Chrysler's light-truck plant in Mexico City is overcrowded and subject to increasing environmental restrictions.

Chrysler built 234,797 vehicles in Mexico last year; about 100,000 were exported. Chrysler's other plant is in Toluca, near Mexico City.

A Chrysler spokesman said the Saltillo move "is not official." But he hinted that "in two or three months there might be news."

U.S. automakers are sensitive to news about capacity increases in Mexico, in part because of the controversy surrounding the proposed North American Free Trade Agreement.

Mr. REYNOLDS. Chrysler is the single biggest importer of United States products in Mexico, as companies go. Pemmix is No. 2, and General Motors is No. 3.

Chrysler has done fairly well in Mexico under protected trade barriers and has had some problems as those trade barriers have come down. Mexico's auto industry is still extremely protected and closed for the very obvious reason that they could not possibly compete on variety and quality with a lot of U.S. products.

Chrysler had to shut down recently a 57-year-old plant near Mexico City, ostensibly on environmental grounds. If you are going to pick plants, let's pick that one as an example of what a powerful auto industry they have down there.

The overall trade numbers are in our favor. The investment numbers going into Mexico are extremely small, particularly for manufacturing. There was some in 1986 or 1984 or something like that. But it has not been going up. It has been going down.

Japan's overall investment, all the investment they have ever put in all the time they have been down there, is $1.5 billion. GM can lose that in a couple of weeks. That is peanuts. The whole maquiladora program is only a little over $4 billion of value added. Again, that is a very, very small number and so is a half million employees.

The main question I still would want to come back to is: What does all this have to do with NAFTA? Does NAFTA improve the situation or not? I argue that it very clearly opens up a young and growing auto market for U.S. parts and trucks and cars.

This country's exports of cars, trucks and parts have increased by almost 70 percent since 1986 in dollar terms.

Mr. PETERSON. Are the people working in these car plants able to buy a car?

Mr. REYNOLDS. That is like saying do the people in the Cadillac Seville plant buy Cadillac Sevilles. That is a silly question.

Mr. PETERSON. I don't think it is at all. Henry Ford said——

Mr. REYNOLDS. Henry Ford was wrong. He was not an economist. Real consumption in Mexico rose by 5.9 percent last year. That is a big number. Obviously, incomes are going up. That is a measure of living standards.

Mr. PETERSON. 5.9 percent of nothing is still nothing.

Mr. REYNOLDS. No, no, it is rising. Living standards are rising. Auto sales are rising very fast. The U.S. Commerce Department has a publication called Industrial Outlook. Check it out.

Mr. PETERSON. Mr. Reynolds, I went down to Mexico and I went into a grocery store. The prices for everyday things that I buy and that every family in America buys are higher in Mexico than they are in the United States.

Mr. REYNOLDS. They have a value added tax.

Mr. PETERSON. I don't care why. I am saying they are higher. If these people are making $2 an hour or even if it is $5 an hour, it is beyond me how you can say that their living costs are so much less.

Mr. REYNOLDS. Housing.

Mr. PETERSON. You mean those tin shacks?

Mr. REYNOLDS. I mean comparable housing, dollar for dollar, similar housing.

Mr. PETERSON. Are we going to have the United States emulate Mexico so we can all live in a tin hut?

Mr. REYNOLDS. In 1985, it was mentioned correctly that the compensation by the U.S. measure is about 15 percent of United States, according to BLS. In 1985 that was also true of South Korea and it was true of Portugal. As economies open up, their real wages grow very fast. I have shown you that they are growing very fast. What more can we say?

Mr. PETERSON. I still get back to this whole idea that somehow or another these living costs are less. A lot of these folks are squatting on property that they don't own and they are building these shacks and they are living in——

Mr. REYNOLDS. I am willing to concede that point. It is not important to the testimony. That is an aside.

This graph is extremely important. The question is: Is productivity rising fast and are wages being held down by the pacto? The answer is absolutely not, by no measure.

Mr. SHAIKEN. I would like to address both these points. Mr. Reynolds was the one who raised the issue of living costs in saying that this dramatically understates it.

I would like to read yesterday's prices in Tijuana and compare them for a few items into how many hours an average maquiladora worker would have to work to purchase that. That, after all, is what it comes down to. You get your check and you go to the store.

Milk yesterday in Tijuana for a quart was 3.9 new pesos. The average maquiladora worker would work 1.25 hours to buy a quart of milk. A dozen eggs, 3.50 new pesos. An average maquiladora worker would work 1 hour. So you have bought a quart of milk and a dozen eggs and a quarter of your day is gone. If you want bread, 2.9, 1 hour for a loaf of bread. If you want a pound of beef, 10 to 15 new pesos for a pound, depending on quality, 3.25 to 5 hours. Your day is done.

You bought maybe a pound of beef, a quart of milk, and a dozen eggs. Is that going to be the consumer market that we are opening up? It is hardly a trivial issue under those circumstances. That is precisely what it comes down to.

What makes this particularly tragic is these are not poor people in a devastated area. These are among the most productive industrial workers in the world.

Mr. REYNOLDS. The maquiladora workers?

Mr. SHAIKEN. Yes.

Mr. PETERSON. I was in Tijuana. I went to the Honeywell plant in Tijuana. I have to say that that plant appeared to be as efficient and as clean, and as well run as any plant that I have seen in the United States. Those folks are making $1.56 an hour. Some of the supervisors who had been there a while were making more.

From there, I went to the grocery store. It is beyond me how these folks can make ends meet. I guess the answer is that they squat in these areas and don't have housing costs. They don't go to the grocery store because they can't afford it. They live on tortillas and some of these other things that we would not consider to be a sufficient diet in the United States.

I think that a lot of folks believe this stuff when they read in the paper that these housing and living costs are less in Mexico. The

only reason they are less is because they are living at a level that we would not tolerate in this country. We don't ask our welfare people to live like that.

Mr. REYNOLDS. Let me try to address what I think was your question about buying back the product. First of all, everyone knows that U.S. exports have almost quadrupled since 1986. They are not necessarily consumer goods. Mexico is trying to, for example, improve its agriculture so that farmers will buy tractors from Caterpillar.

Mr. PETERSON. These little 15-acre farmers are not going to be able to buy any tractors from Caterpillar.

Mr. REYNOLDS. They are buying tractors from Caterpillar. Ask Caterpillar. They are buying them like crazy.

Mr. PETERSON. New tractors? My farmers cannot afford to buy new tractors. I would like to see any one of those little 15-acre farmers who is buying a tractor.

Mrs. THURMAN. If you would yield, those are the ones that were sold to Florida after Hurricane Andrew, the boxes of limes that used to be $8 for $25.

Mr. REYNOLDS. Our exports of machinery of all sorts of steel, of all sorts of industrial products, chemicals, paper has been soaring, also services. Over $40 billion in merchandise exports last year, but we had almost $9 billion in service exports. This is business-to-business transactions. There are some consumer goods, obviously fruits and vegetables.

Mr. PETERSON. I think that is one of the problems, that we are going to—the big market in Mexico—is going to be sending our technology down there, sending our more efficient plant and equipment down to Mexico.

Mr. REYNOLDS. My gosh, they might develop and grow. But that doesn't hurt us when other countries do well.

Mr. PETERSON. Yes, it does when their wages are rising. They are making less money now than they were in 1981, based against the U.S. dollar, according to the Bureau of Labor Statistics. In 1981, it was $2.74 compared to the U.S. dollar.

[The chart follows:]

HOURLY COMPENSATION COSTS FOR PRODUCTION WORKERS IN MANUFACTURING INDUSTRIES

MEXICO, 1975-1992

I ALL MANUFACTURING INDUSTRIES

YEAR	HOURLY COMPENSATION COSTS IN PESOS	EXCHANGE RATE: PESOS PER U.S. DOLLAR	HOURLY COMPENSATION COSTS IN U.S. DOLLARS	U.S. workers Hourly compensation costs; production workers, manufacture industries, all. manufacturing ind.
1975	18	12.50	1.44	6.36
1976	22	14.46	1.52	6.92
1977	29	22.60	1.28	7.59
1978	35	22.78	1.54	8.28
1979	40	22.82	1.75	9.04
1980	50	22.97	2.18	9.87
1981	67	24.52	2.73	10.87
1982	107	56.40	1.90	11.68
1983	170	120.1	1.42	12.14
1984	239	167.8	1.54	12.55
1985	405	256.9	1.58	13.01
1986	651	611.8	1.06	13.26
1987	1,390	1,378	1.01	13.52
1988	2,834	2,273	1.25	13.91
1989	3,635	2,461	1.48	14.32
1990	4,620	2,813	1.64	14.91
1991	5,876	3,018	1.95	15.60
1992	7,280	5,102	2.55	16.17

SOURCE: [redacted] U.S. DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS, OFFICE OF PRODUCTIVITY AND TECHNOLOGY, MARCH 1993.

UNPUBLISHED DATA

Introduction

The accompanying tables present international comparisons of hourly compensation costs for production workers in manufacturing industries. The total compensation measures are prepared by the Bureau of Labor Statistics in order to provide a better basis for assessing international differences in employer labor costs. Comparisons based on the more readily available average earnings statistics published by many countries can be very misleading: National definitions of average earnings differ considerably; average earnings do not include all items of labor compensation; and the omitted items of compensation frequently represent a large proportion of total compensation.

The compensation measures are computed in national currency units and are converted into U.S. dollars at prevailing commercial market currency exchange rates. They are appropriate measures for comparing levels of employer labor costs. They do not indicate relative living standards of workers or the purchasing power of their income. Prices of goods and services vary greatly among countries, and commercial market exchange rates are not reliable indicators of relative differences in prices.

Definitions

Hourly compensation is defined as (1) all payments made directly to the worker --pay for time worked (basic time and piece rates plus overtime premiums, shift differentials, other bonuses and premiums paid regularly each pay period, and cost-of-living adjustments), pay for time not worked (vacations, holidays, and other leave), seasonal or irregular bonuses and other special payments, selected social allowances, and the cost of payments in kind--before payroll deductions of any kind, and (2) employer expenditures for legally required insurance and contractual and private benefit plans. In addition, for some countries, compensation is adjusted for other taxes on payrolls or employment (or reduced to reflect subsidies), even if they do not finance programs that directly benefit workers, because such taxes are regarded as labor costs. For consistency, compensation is measured on an hours-worked basis for every country.

The BLS definition of hourly compensation costs is not the same as the International Labour Office (ILO) definition of total labor costs. Hourly compensation costs do not include all items of labor costs. The costs of recruitment, employee training, and plant facilities and services are not covered because data are not available for most countries. The labor costs not covered account for no more than 4 percent of total labor costs in any country for which the data are available.

Mr. REYNOLDS. Pacto began in 1988. What does it have to do with the pacto?

Mr. PETERSON. I never said that this worked or didn't work. All I am saying is that in 1981 they were making, according to this, \$2.73 an hour in the United States and now in 1992 it is \$2.35. It is hard for me to understand how they improved their situation in Mexico. This is our Bureau of Labor Statistics.

Mr. REYNOLDS. There is no question that Mexico went through absolute hell from 1982 to 1987. I believe also their productivity did. We are not sure about that.

The question is what is happening under the Salinas government and what is going on now. That is what I have addressed. Interesting, Señora Lujan's testimony has salaries stopping in 1987, when the question is what has happened since pacto in 1988.

Mr. PETERSON. It went from \$1.25 an hour to \$2.35. If it went up 18 percent from here, they are never going to get to the point where they can buy anything from us, these folks that are making these kind of wages.

Mr. REYNOLDS. Do you expect wages to suddenly go from \$3 to \$30? That is not the way wages go. They are rising very rapidly. They are rising in real terms and they are rising in dollars. They are causing them a lot of problems because their unit labor costs are making them uncompetitive. The people who are saying Mexico will have to devalue are saying Mexico cannot compete. I happen to think they can, but it is very painful.

Mr. SHAIKEN. Mr. Chairman, I think that this whole issue of how rapidly wages are rising is an important one. I also fear the notion of everyone's eyes glazing over, throwing numbers back and forth. But I think this one is fairly simple to answer because real wages have not risen by anything remotely like what Mr. Reynolds is talking about during the period which he is discussing.

I prefaced it by saying we both agree that Mexico took a horrible shock in the early 1980's down to 1987. Then it began slowly inching upward. We have to remember that if you use 1987 or 1988 as the base year, it would be like starting from the trough of the Great Depression and saying, well, you know, by 1940 things had improved. They had, but you are still starting at such a low level that it makes the figures somewhat misleading.

However, using that point of reference, accepting that for a moment, let me cite you the latest index figures from the Banco de Mexico. These are in real pesos. The dollar figures that Mr. Reynolds is using are not adjusted. They are picking up the vagaries of the exchange rate.

If we just use real Mexican pesos from 1987, the year he wants to compare with, to 1992, real wages in Mexico rose from an index of 100 in 1987 to an index of 128 in 1992. Productivity rose in real pesos from 100 in 1987 to 125 in 1992. In other words, wages were slammed down by 1987 to artificially depressed levels. Since then, wages and productivity have tracked from that artificially low base. That is far from 18 percent annual wage gains. That is simply not true.

Mr. PETERSON. Mr. Reynolds, I was curious, we have this paper here which we put into the record from the NAFTA summit that you took part in. How come you didn't make the same statement

to us that you made to the NAFTA summit? You changed your testimony considerably.

Mr. REYNOLDS. The only change I am aware of making is that instead of estimating productivity, I used Banco de Mexico numbers for 1991 and 1992.

Mr. PETERSON. But a lot of the points that you made at the summit I don't find in your statement. It is a different tone. Are you putting a different spin on it for us?

Mr. REYNOLDS. It largely has to do with the fact that we are having some sort of a contest here.

Mr. PETERSON. I didn't ask you to come here to have a contest.

Mr. REYNOLDS. The NAFTA summit paper, for example, deals at some length with Professor Ed Leamer of UCLA. He is not here. It would not be appropriate for me to take him on—or Pat Choate. What do you find different?

Mr. PETERSON. Just kind of the tone of the thing and some of the statements you made here that I find to be, I would say, almost outrageous are not in this. Some of them are here and some of them are not. I was just curious.

Mr. REYNOLDS. I am making different points.

Mr. PETERSON. One of the things you say in here about auto workers require 4 months of training before they can go to work, evidently, in Mexico, compared to 1 or 2 weeks in the United States.

Mr. REYNOLDS. That is simply taken from Professor Shaiken's paper.

Mr. PETERSON. Is that true?

Mr. SHAIKEN. It is true, but a highly stylized way of putting it. It is an opportunity. In Mexico, Nissan workers in Aguas Calientes receive roughly 2 weeks of training. Ford choose to provide 4 months of training at Hermosillo initially because it had an opportunity to develop, not just production workers, but to provide every worker in the plant with the training that only a skilled worker would receive in the United States. That wasn't because they had to.

Mr. PETERSON. That is why they have the good statistics in that plant.

Mr. SHAIKEN. Absolutely, because they have an unusually deep skill base.

Mr. PETERSON. My son works for Saturn. They put more time than that into training people. If you look at Saturn's numbers, they are more productive than any of these companies we are talking about.

Mr. SHAIKEN. I think Saturn is a very powerful example of just that. It isn't a liability. Mr. Reynolds is quite right; you will need more training in Mexico. There is no question. You would not need that big a gap. I was simply citing that gap as an opportunity.

To provide that kind of training to a work force really gives you a depth of skill that, obviously, in this case, has paid off quite considerably.

Mr. PETERSON. If they did this all throughout their industry down there, we would have a lot of competition that we probably would have a hard time keeping up with.

Mr. SHAIKEN. Yes.

Mr. PETERSON. This discussion about the wages and whether these benefits are included, you know, whatever they are, profitsharing and all these other things, we had these witnesses in here, whenever we had this last hearing, from Mexico where they basically told us that they did not receive these benefits. We had them under oath. Are you saying that they were lying to us?

Mr. REYNOLDS. I am sure you can find two or three people who do not get benefits here. I am using the U.S. data in all my graphs. I am saying if I used the Mexican data, that include all the prestaciones, the black bar on this graph would not fit, it would be so high. It would be on the average of 30 some odd percent. Somewhere in between there is probably the truth, because among other problems Mexicans separate the maquiladoras.

Mr. PETERSON. According to what we know, the Bureau of Labor Statistics doesn't include these benefits, though.

Mr. REYNOLDS. They specifically say they don't include everything. I don't know what they don't include, but they say they don't include everything.

Mr. SHAIKEN. If I could address this whole issue of profitsharing for a moment. It is not just one or two workers who haven't gotten it. The primary components of Mexico's export sector are the maquiladors. That is where you have, as Mr. Reynolds pointed out, 530,000 workers today. Almost all the maquiladors, if not all the maquiladors, are set up as cost centers. That means they record no profit whatsoever in Mexico.

Therefore, there is no profit to share because no profit shows on the books. To avoid a political embarrassment with the Mexican Government, most maquiladoras agree to pay 2 percent of their Mexican costs, which are primarily labor, into a bonus or profitsharing fund.

I am not sure if the BLS does or does not include it. The BLS total compensation data is $1.60 a hour for maquilas, wages and benefits. If it doesn't include it, and we add an additional 2 percent, which is pretty much what they are paying, or even an additional 5 percent, let's say, then we are talking about adding 8 cents. So instead of earning $1.60 an hour in total compensation, if we add 5 percent, they would be earning $1.68 an hour. That is meaningless.

What Mr. Reynolds referred to in his earlier paper as notoriously generous fringe benefits in Mexico are highly misleading. Many maquiladors do in fact provide lunch, but most workers would prefer to have the money in their paycheck to buy their lunch. All the benefits are included of that variety in the BLS numbers.

Mr. PETERSON. I am reading from the BLS thing here. It says: "Total compensation: All payments made directly to the worker, vacation, holiday, special payments, payroll deductions, employee expenditures for legally required insurance, and other contractual and private benefit plans."

It sounds to me like they have included most all of these things.

Mr. REYNOLDS. The release that has those numbers explicitly says there are omitted items of compensation in almost all countries, and in the case of Mexico they are significant.

Harley Shaiken is absolutely right, the profitsharing does not apply to maquiladoras. Let's put the maquiladoras in perspective

in two ways. The value added of all maquiladoras is enough to pay for one-tenth of their imports from the United States. How are they going to get the dollars to pay for everything else? It is really quite small; $4 or $5 billion of value added is just not a very big industry.

No. 2, under NAFTA, maquiladoras are very seriously threatened. They cease to function. It is no particular advantage in setting up a maquiladora. They have no advantage that is not available to firms in Indiana. So why go down there? So maquiladoras are an interesting subject. I am critical of them, too. If you want to get rid of maquiladoras, pass NAFTA.

Mr. SHAIKEN. I think that is a bit misleading, because maquiladoras don't disappear. In effect, all Mexican manufacturing becomes one large maquiladora. So it is not as if they go away. It is as if there is not a unique company building, a plant on the border which today might be called a maquiladora, would not be called a maquiladora. So the legal status changes, but this is far from saying the concept or the operating pattern disappears. It surely doesn't.

Mr. PETERSON. As I understand it, the requirement that they use American-made parts, that goes away, am I not correct? I mean, right now, as I understand it, they have to use American parts. They have to ship them in, they are put together, shipped back and distributed.

One of the reasons these numbers look like they do is because they are counting, when they send those parts in to be assembled, they are counting them and then counting them again when they come out. So they are double counting them.

Mr. REYNOLDS. All a maquiladora is, is Mexico drops its tariff on United States—let's say the fabric that goes into Haggar slacks. Haggar makes slacks in Mexico. All the material is American; all the cutting, all the design is United States. Then we send them down there and they are sewn. So the sewing is the value added. We, in turn, when it comes back don't tax our own fabric, because that would be stupid. So it is a mutually beneficial—it is a free trade zone.

Mr. PETERSON. They could buy that fabric wherever they wanted to if NAFTA passed.

Mr. REYNOLDS. Actually not, because NAFTA is quite restrictive on where you buy textiles. America is highly competitive when it comes to textiles, and Mexico is not. They are in a lot of trouble.

Mr. PETERSON. But like a lot of other industries, the threat is from other countries.

Mr. REYNOLDS. The threat is from the United States.

Mr. PETERSON. Why are the Mexican companies against NAFTA?

Mr. REYNOLDS. They are not. Our exports of textiles to Mexico are quite large. Fabric is something we are very strong in. I didn't want to get off the subject so much. I wanted to say something about the maquiladoras versus NAFTA.

The big difference, No. 1, is that under a maquiladora program you have to put the plant in Mexico. Under NAFTA, you can leave it in Indiana. It will be treated the same way. No. 2, a maquiladora has to export, cannot sell, in almost every case, to Mexicans. Under

NAFTA, you can't do that anymore. Things like the Ford Escort become available to Mexicans.

Mr. PETERSON. But they can't buy them.

Mr. REYNOLDS. Oh, yes, they buy a lot of cars. I don't know where you got that idea. It is part of our big exports.

Mr. SHAIKEN. For 4 years Ford could have sold the Escort in Mexico and chose not to, not because they legally couldn't but because there is not a market for an additional vehicle. They had the opportunity but found it wouldn't make economic sense in that period.

Mr. PETERSON. Mrs. Thurman.

Mrs. THURMAN. Just to your point on the textile industry, just recently I read something where the competition is now, of course, coming from Asia who now is starting to come back into Mexico, and in fact are building the plant, which has had an effect also on wages in Mexico because now they are trying to compete with the Asian wage and how low they are over there. And the purpose for them going to Mexico is specifically if NAFTA were to be adopted, that they could come directly into the United States, which then has a second impact on us from the outlying countries.

Mr. PETERSON. I think that is right.

Mr. McHugh, do you have any questions? I have been monopolizing. Are you reluctant to get into this fray here?

Mr. MCHUGH. Reluctance or intelligence, I am not sure which.

You had your explanation of figures. My father used to tell me, Mr. Chairman, you know, John, if you stick one foot in a bucket of ice water and one in a bucket of boiling water, on average, you are comfortable. I don't know whose foot is where in this.

Mr. SHAIKEN. I don't want to ask.

Mr. MCHUGH. Two observations: I was in Japan 18 months ago and a cantaloupe cost $45. And I was at the Red Sage on 15th Street here and a tortilla dinner was about $22. So, again, it is all relative.

It seems to me what we have heard through all of this is that there seems to be a real question about the status of the Mexican worker. And I think a good many people would argue that they are not as well off as they should be, not as well off as we would like to have them. The question that arises in my mind, what is our responsibility as a country to effect that situation, if we can, and second, how do we go about doing that.

Professor Shaiken, with respect to that issue, I assume you would agree that the Mexican worker is not doing as well as some would say. Does NAFTA provide us an opportunity to intervene in a positive way, or does it not?

Mr. SHAIKEN. I think that is one of the very central questions, because all the arguments earlier really don't determine one way or another necessarily one's position on NAFTA. I would argue that NAFTA, as presently constructed, will not improve the condition of Mexican workers. They could, in fact, even wind up in a worse situation.

What would then happen is, whatever their situation, it would have a large demonstration effect on the United States as the economies become integrated at an accelerated pace. So the notion of why NAFTA wouldn't do that is simply because NAFTA has ig-

nored the fact that while Mexico made very large strides through most of the 1980's to harmonize investment guarantees, the structure of its markets, intellectual property rights, and then accelerated that during NAFTA, no such comparable movement has occurred vis-a-vis either free labor markets or labor rights within Mexico.

So unless that issue is addressed, then NAFTA in fact could wind up worsening the situation of many Mexican workers as their wages remain tied down as part of an investment strategy while enrollment continues to grow.

Mr. McHugh. So you might argue that NAFTA could, in fact, have that effect if we did certain things to the agreement?

Mr. Shaiken. If a number of things were done in terms of real, effective side agreements dealing with labor rights as well as unilateral changes by the Mexican Government to create further independence within its labor markets in a way that is analogous to what they have already done in terms of investment, then increased economic integration could be a benefit.

Without those two, that is, unilateral changes by Mexico and very serious and effective side agreements, then the economic integration I think would have a very negative effect, or the accelerated integration.

Mr. McHugh. Absent America or any other nations entering into an open, competitive market with Mexico, how would you suggest our policies might affect Mexico in a positive way? How else do we engage the question?

Mr. Shaiken. Mexico, as part of its long-term strategy, very much wants a free trade agreement with the United States. As part of the price for that free trade agreement, certain changes by the Mexican Government, vis-a-vis its labor markets, would be an important step. That would allow Mexican workers no more than the ability to independently change their own circumstances and link their considerable productivity in the export sector as well as elsewhere to their wage levels. That would be part of it.

A second part would be specific negotiated language that ensures that violations are met with effective and strong sanctions as a realistic deterrent.

Then I think we have to talk about broader issues of the timeframe for these changes. But without these preconditions, we are accelerating a situation that may not simply harm Mexican workers, but may make Mexico the locus of wage determination for many U.S. industries which affect not simply wage levels but our prosperity and consumption as well.

Mr. McHugh. So to summarize, if your interest is bettering the condition of the Mexican worker, in your opinion free trade is a powerful inducement to the Mexican Government?

Mr. Shaiken. Free trade could be a powerful inducement, but not an after-the-fact inducement, that is, simply the notion of providing free trade and then on its own these things will happen I think is fundamentally challenged by 70 years of Mexican history.

Mr. McHugh. I am not arguing the sequence. I am arguing the concept.

Mr. SHAIKEN. Free trade as a possibility, because we already have considerable trade. But broader trade and eliminating these limits as an inducement could be quite powerful.

Mr. MCHUGH. Mr. Reynolds, your comments?

Mr. REYNOLDS. Let's remember what NAFTA is, primarily. It is a reduction of tariffs and trade barriers on both sides. Other things being equal, that has a direct impact on real income. It lowers the cost of living. We put 32 percent tariff on brooms. That means every time you buy a broom it costs 32 percent more than it would if we have freer trade.

Should we be protecting the broom industry? I would argue maybe it is not on the cutting edge of technology and maybe you should kiss it good-bye. But that is not what you will hear in lobbying efforts.

You hear about the average trade barrier. Well, if your trade barrier is like a total ban, it doesn't appear in the average. Or if you have a very high tariff such as our 765 percent tariff on processed tobacco stems, an important element of national defense, then no trade occurs in that product. It doesn't show up in the average.

But yes, the reduction of trade barriers has and will continue to increase real wages by lowering living costs in Mexico, by lowering those grocery store prices in Mexico. Lowering the VAT in Mexico has had the same effect.

Then they are economic effects that occur not necessarily painless. Basically, it involves getting your resources out of businesses that are not competitive and into others that are. These are efficiency and productivity gains, and economies of scale in dealing with a bigger market.

Mexico is also trying to do trade agreements with Chile and the rest of Latin America, in order to gain economies of scale, specialize in a few things. Don't try to produce a lot of different automobile models, they can't. Produce a few. Import the others. Those will give you the kind of efficiency and productivity gains that raise living standards. The same thing happenings on our side. The studies show just that.

Mr. MCHUGH. Thank you. Thank you, Mr. Chairman.

Mr. PETERSON. Would you say that NAFTA—one of the reasons these big companies are so interested in it is that they feel their investments in Mexico would be more protected if we had a NAFTA in place? Aren't they concerned about being taken over, nationalized like they were one other time? Isn't this something that is behind——

Mr. REYNOLDS. Companies that are already there went there because the trade barriers in Mexico are high, in fact prohibitive in the case of automobiles. They simply didn't let you bring cars in. If you wanted to sell in the Mexican market, you built plants. That is why Ford has been there since the 1920's and Chrysler and GM and nine others are there.

Those particular companies, I would argue, and I think I hear it in their testimony, are afraid of competition from the United States. Because they will have to shut down their Mexican plants. Nobody wants to do that. So they have tried very hard, particularly to make sure that the opening of the Mexican market was gradual and that it was done in such a way that it foreclosed, if possible,

companies like Honda in Ohio, Mitsubishi in Illinois, and Subaru in Indiana.

So that is kind of the opposite of where you were coming from. If you think about it, companies like trade barriers because it allows them to raise prices and get a monopoly.

Mr. PETERSON. You said investment wasn't increasing, and it was really relatively small.

Mr. REYNOLDS. It is trivial.

Mr. PETERSON. And you have stated it is going to increase under NAFTA.

Mr. REYNOLDS. Foreign investment in this country adds up to $420 billion. That is a pretty significant number. The United States attracts——

Mr. PETERSON. Because we are the safest economy in the world, and the safest place to put your money.

Mr. REYNOLDS. And low unit labor costs.

Mr. PETERSON. I don't know if I agree with that.

Mr. REYNOLDS. Labor costs are usually 20 percent or less of—we can get into that, but it depends, in the high-tech industries, it is even lower. But——

Mr. PETERSON. I am going to——

Mr. REYNOLDS. Labor costs are comparable to what they are in Mexico.

Mr. PETERSON. I am going to give Mrs. Thurman a chance to get into this. She can get through all of this.

Mrs. THURMAN. Right. Just to kind of add, where I find some fault in the testimony is that I might believe that some of our companies go down, particularly in the auto industry, so they have a new market. But where that doesn't help me is with Smith Corona, Zenith, some of those other companies who have in fact closed and come over or down there, just absolutely have closed up and gone down. That is where I think you come into a difference with the wage issue or, as in Mr. Shaiken's testimony, land, you know, all of the other kinds of things that might be included in putting a package deal together.

So if you could respond to that, it would be helpful.

Mr. REYNOLDS. I notice that you didn't mention RCA, Philco, Admiral——

Mrs. THURMAN. I meant, et cetera.

Mr. REYNOLDS. Many consumer electronic companies went down to Mexico and we never saw them again, good-bye. Obviously, the numbers don't add up to much or they would show up in the investment figures. Those figures are small and falling.

On the other side, there are a couple of companies in Mexico, more than two, but two that really stand out, that is Vitro and Cemex, who have invested very heavily in building up facilities in the United States, ironically.

Why don't we say, oh, my gosh, they are stealing jobs from Mexicans? They are, in a sense, maybe, but you don't necessarily want to move cement and glass over long distances, so it makes sense to do it closer to the markets.

The total employment picture in Mexico is falling. There again, if you think there are a lot of jobs going to Mexico, you have an

awful hard time finding them. Because there is no increased employment in manufacturing.

Mrs. THURMAN. However, I will tell you that the glass part of it we had a couple of weeks ago. A man that is in direct competition with Vitro who is now paying a 35 percent fee to go into Mexico. So—and they are losing jobs because of it. So again, it is a direct effect on the American worker.

But I was interested in your statement, your ending statement to us when you said that Americans should not be afraid to compete with Mexico on an even basis. Let me just let you know that I don't think there is an American in this country that is afraid to compete with Mexico. However, in NAFTA, as we have seen it, or know about it, it is not on an even basis. Could you give me a better explanation of what you think an even basis is?

Mr. REYNOLDS. I would like to correct myself. It is not an even basis, because since Mexican tariffs are far, far higher than ours on the products that matter, NAFTA is tilted heavily in our direction. The auto engine example is a classic. We have no tariff on auto engines. Theirs is 15 percent. We need to level that playing field. In that case, we will compete better, obviously, because auto engines in Mexico will be 15 percent cheaper and be able to compete with that—what is effectively a subsidy.

A tariff is effectively a subsidy on their domestic industry. It is like taxing the consumer and giving the 15 percent to the business, which is often an American business.

Mr. SHAIKEN. I think it is ironic Mr. Reynolds should use this particular example. Mexico is now either among the world's largest or the world's largest exporter of auto engines.

Mr. REYNOLDS. No tariff.

Mr. SHAIKEN. 1992, 1.3 million engines. OK, no tariff.

Why then has the Mexican Government projected that in 2 years, meaning that these investments are already locked in and the plants are being constructed, why have they projected that by 1994 the value of Mexican auto engine exports will double to $2.4 billion compared at that last year?

You are arguing that with NAFTA all of a sudden this will be reversed, engines will start flowing down to Mexico? Somehow the Mexican Government, based on their assessment, and I have looked at the plans of this industry, is aware that auto engine exports will double, high tech, a high value added product, and a pivotal part of any manufacturing base. That simply and categorically challenges the speculation that with NAFTA the flow will reverse, because these investments are locked in.

Mr. REYNOLDS. With the chairman's permission I would like to add one more graph to my testimony. This comes from a study by Berry, Grilli & Lopez from the National Bureau of Economic Research. It is a little dated. And these are professors respectively from Harvard, Yale, and the University of London. I grant this is a good reason to be suspect, but nonetheless they are good numbers.

Mrs. THURMAN. Where did you graduate from?

Mr. REYNOLDS. Basically it says the Mexican imports are growing a little faster lately and exceed their exports in automotive trade. I find that suspicious given—or surprising, given all of the

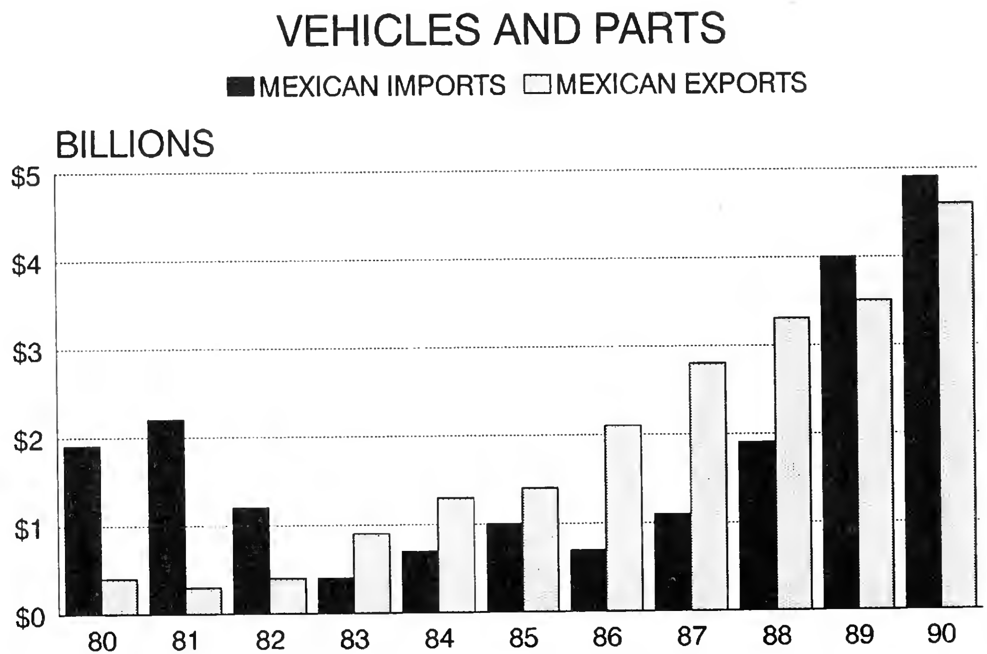
extremely restrictive regulations, domestic content, trade balancing, 20 percent tariff on cars in Mexico. Ours is 2.5. It is really sort of surprising.

Now, what happens when they take those trade barriers down? I think clearly we are going to be exporting a heck of a lot more of something, because the cost of that something goes down and demand will slope down. There is no way of getting around basic logic for that.

Will they export a lot of engines? Sure. So will we. We are already selling a lot of engines down there, as you know, because they build several models of engines and several models of cars. You have to sell—they have to sell to us in order to acquire the dollars to buy from us. But lately they have been getting those dollars by selling stocks and bonds and running a big, big trade deficit in manufactured goods, particularly cars.

[The chart follows:]

U.S./MEXICO AUTOMOTIVE TRADE



Berry, Grilli & Lopez, National [reau of Economic Research

Mr. SHAIKEN. I would like to raise one further issue on this, then comment on one point Mr. Reynolds raised earlier.

On cars, the consulting group projects Mexico will export 1 million vehicles in 16 years and import 180,000 vehicles. That is an overwhelming balance of exports. If we look at the fact that GM is building a new truck plant in Mexico, that Nissan has invested $1 billion additional in an assembly plant in Mexico, Ford has been expanded, Volkswagon is likely to expand, if we look at all of this, we see Mr. Reynolds is speculating on an industry where there is a lot of available data, because investments have to be locked in early. No one projects, that I am aware of, that Mexico will be importing more cars or anywhere near the number of cars that it will be exporting.

One further very brief point. I mentioned the Mexican manufacturing base has decreased to $2.4 million, and that is true. The flaw there is if the Mexican manufacturing base is decreasing, where is the expanding consumer market going to come from? What, in fact, that doesn't include that is of direct interest to United States workers is Mexico does not define the maquiladora industry as part of its manufacturing base. So the 500,000 workers is there and the expansion from 120,000 in 1980 to 530,000 this year is not included in Mexico's manufacturing figures.

Mr. REYNOLDS. But it is included in the figure I gave you, the 1.8 percent growth in manufacturing.

Mr. PETERSON. The Hermosillo plant which according to your chart—who did this study? It shows that plant to be pretty efficient and the quality is good and so forth. But those workers are getting, what, $2, $3 an hour?

Mr. SHAIKEN. A low $2 an hour. I think their average wage is around $2.15 an hour.

Mr. PETERSON. We had these folks come in and testify about how difficult it is for unions being controlled by the government and everything. That is basically what is going on there. They are very productive, but they are not getting any of that productivity. They have no way—they have no leverage to get any better wages out of that situation. Is that not basically how it works?

Mr. SHAIKEN. Very little leverage, that is correct.

Mr. PETERSON. And do you know what kind of wage increases they have been getting in that specific plant in the last 4 or 5 years? Maybe that is in your study.

Mr. SHAIKEN. I have those numbers. The only number I am familiar with directly is in the last set of contract negotiations. They won effectively a 14 percent wage increase at a point when inflation for the year was projected to be 12 percent. So what has happened is, of late, the wages are already so depressed—if you look at 1987 when total compensation was $1, wages and benefits, it couldn't go much lower. It was already at a point when it was impossible to survive at that level.

What has happened since, even in the export sector, is you have a situation where, in fact, wages are going up; they are basically tracking productivity, but off such a low base that the gap between the United States and Mexico remains very, very considerable. And I would argue it is a gap based on wages that are low not because of some invisible hand but are low because they are artificially de-

pressed. A combination of the no leverage you are speaking of and in some industries of employers relatively openly meeting and setting wage levels for an area and accepting whatever turnover may occur, but deciding not to compete based on wages.

Mr. PETERSON. So even if all this good stuff happens, it is probably true this is not going to end up in the pockets of the Mexican workers. They are going to get basically what the government decides it has to give them, and that is kind of how it works?

Mr. SHAIKEN. That has certainly been the history in Mexico.

Mr. PETERSON. There is nothing in place really to change that.

Mr. SHAIKEN. There is nothing institutionally in place that is likely to change that.

Mr. PETERSON. And the side agreements, from what I have read about them, there is evidently some kind of preamble that is going to be adopted by all the different countries that is going to say that they should make sure the workers get some of the benefits and so forth and so on, but there is nothing there to make that happen?

Mr. SHAIKEN. Yes, as far as I am aware, unless there is some major change, there is nothing in those side agreements that would remotely be sufficient to impact this kind of institutional change that would be necessary to allow basically open labor markets and to allow workers within those open labor markets, that they have a role of setting their wages that is independent of government policy.

Mr. PETERSON. I don't know how we get into these trade agreements. We get into it in such a way that we get the other half of the equation. I think free trade is a good thing, if we could just get benefits to go beyond the 13 billionaires—in Mexico—and the government, which is where it is going to end up. I see you have been squirming there, Mr. Reynolds.

Mr. REYNOLDS. Everything seems to focus on this one kit car. It is basically a United States car put together in Mexico. Labor rights. They had a strike there. It lasted 17 days. They got pay increases of 14 to 16 percent. Was that a substantial pay increase? Obviously it was. Mr. Shaiken said $2 per hour? His paper says "about five." We don't need "about" numbers. We need some numbers, footnotes, and of course, we need facts.

Mr. PETERSON. We had testimony in this committee that one of these other plants, when they tried to strike, we heard that people were shot and one person was killed. So that doesn't seem to me to be a kind of a situation where they have the open ability to strike. That is pretty heavy intimidation.

Mr. REYNOLDS. I am not aware of the testimony so I can't comment on it. There was a strike at Hermosillo and no one was killed, to the best of my knowledge.

Mr. SHAIKEN. That was a very controlled strike. It is a CTM union. Discontent was so high that the choice was allowing some real explosion in the plant or walking out for a limited period and walking back in once the discontent had diffused. By no stretch of the imagination is that an example of open labor rights. As far as the numbers, the $5-an-hour figure is a very conservative, total compensation figure to include everything and then some. The actual midlevel wage range, which is close to the average in the plant, is $2.19 an hour.

Mr. PETERSON. Are there any other questions from members? Mrs. Thurman.

Mrs. THURMAN. Just something that was on NPR this morning, because I think it does go to the wage issue and some of the strikes, that the Mexican economy has, I think, grown to like 12 or 13 billionaires now in the last couple of years, which tells me there is money being made down there, but how is the money being spent I think is part of the question here. And how is that being controlled, and not getting to the workers who are actually being more productive. I think that is a part of this whole issue, too.

Mr. PETERSON. Mr. McHugh, do you have any final——

Mr. MCHUGH. No, thank you, Mr. Chairman.

Mr. PETERSON. Well, it is 12 o'clock high here, and we will call it a day. We appreciate very much our witnesses being with us. It has been a spirited discussion. I hope it helped to illuminate NAFTA.

[Whereupon, at 12 m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]

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